No. ____

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IN THE

Supreme Court of the United States

HENRY C. YUEN and ELSIE M. LEUNG,

Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION and GEMSTAR-TV GUIDE INTERNATIONAL, INC.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 78u-3(c)(3), is properly construed to empower a district court—upon application of the Securities and Exchange Commission prior to the commencement of any civil enforcement action—to freeze contractually guaranteed payments about to be made to corporate executives for unpaid salary, bonuses, severance and vacation pay as "extraordinary payments," without requiring any showing that the payments were improperly obtained, illegitimate or excessive in comparison to payments made by comparable companies to similarly situated executives.

2. Whether, by permitting a pre-complaint seizure of assets by the SEC without requiring a showing of probable cause, or even reasonable suspicion, to believe that wrongdoing has been committed by the owner of the seized assets and a nexus between the seized assets and the wrongdoing, Section 1103 violates the Fourth Amendment.

3. Whether Section 1103 is void for vagueness as applied because the SEC misled Petitioners as to its intent to apply the statute to the payments to be made to Petitioners.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and *en banc* opinion of the United States Court of Appeals for the Ninth Circuit entered on March 22, 2005, which affirmed an escrow order issued pursuant to Section 1103 of the Sarbanes-Oxley Act of 2002 freezing monies due to Petitioners.

OPINIONS BELOW

The *en banc* opinion of the United States Court of Appeals for the Ninth Circuit is reported at *SEC* v. *Gemstar-TV Guide International, Inc.*, 401 F.3d 1031 (9th Cir. 2005), and is reproduced in the Appendix hereto at pp. 68a-123a.

The panel opinion of the Ninth Circuit, which reversed the District Court's grant of an escrow order, and which in turn was reversed by the *en banc* opinion, is reported at *SEC* v. *Gemstar-TV Guide International, Inc.*, 367 F.3d 1087 (9th Cir. 2004), and is reproduced in the Appendix hereto at pp. 23a-67a.

The District Court's opinion, granting the SEC application for an escrow order, was filed on June 20, 2003, in *SEC* v. *Gemstar-TV Guide International, Inc.*, Docket No. CV 03-03124, U.S. District Court, Central District of California, and is not reported. This opinion is reproduced in the Appendix hereto at pp. 1a-22a.

JURISDICTIONAL STATEMENT

Petitioners request that this Court review the *en banc* judgment of the United States Court of Appeals for the Ninth Circuit entered March 22, 2005, affirming the asset freeze issued pursuant to Section 1103 of the Sarbanes-Oxley Act of 2002. This petition for certiorari is being filed within 90 days of entry of the order for which review is sought, as is required by Supreme Court Rule 13. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 78u-3(c)(3), provides:

> (3) TEMPORARY FREEZE
>
> (A) In General
>
> (i) Issuance of temporary order
>
> Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court

supervision, those payments in an interest-bearing account for 45 days.

(ii) Standard

A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

(iii) Effective period

A temporary order issued under clause (i) shall—

(I) become effective immediately;

(II) be served upon the parties subject to it; and

(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

(iv) Extensions authorized

The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

(B) Process on Determination of Violations

(i) Violations charged

If the issuer or other person described in subparagraph (A) is charged with

any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

(ii) Violations not charged

If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.

The Fourth Amendment to the United States Constitution provides:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

The Fifth Amendment to the United States Constitution provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb, nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATEMENT OF THE CASE

This case involves another effort by the government to distort a statute beyond its intended and logical scope in order to achieve a politically popular result. In the case below, the SEC invoked Section 1103 of the Sarbanes Oxley Act of 2002—a statute that permits the SEC, during the course of an investigation, to freeze "extraordinary payments" about to be made to corporate officers—to temporarily freeze approximately thirty-eight million dollars due to Petitioners Henry C. Yuen and Elsie M. Leung. The SEC claimed that it needed a temporary freeze of these funds while it investigated the Petitioners. Yet, over two years later, and as the result of a plainly erroneous and unfair interpretation of the statute by the Ninth Circuit, Petitioners' funds remain frozen despite the SEC's total failure to show that the payments were "extraordinary" in any respect or that they were improperly obtained. Moreover, the SEC enforced Sec-

tion 1103 in an arbitrary manner by misleading Petitioners in October and November 2002 as to the SEC's intent to apply the statute to the restructuring payments.

Factual Background

The payments at issue arose from Yuen and Leung's employment at Gemstar-TV Guide International, Inc. ("Gemstar"), and their departure from that employment in 2002. Yuen, the then-CEO of Gemstar, was party to a January 1998 Employment Agreement with Gemstar's predecessor, Gemstar International Group Limited. ("GIGL") (ER 119-40)[1] Under the Employment Agreement, Yuen was to receive as compensation (i) a base salary, (ii) annual "merit" and "incentive" bonuses, and (iii) vacation pay. (ER 122-23, 125, 138-40.) Including an automatic renewal period, the Employment Agreement was for a term of eight years. (ER 119-20) In the event of a termination without cause, the agreement provided that Yuen would receive a lump-sum severance payment in an amount equal to his then-current base salary "multiplied by five." (ER 129)

Leung, the then-CFO of Gemstar, also had an employment agreement with GIGL. (ER 141-58) Under her March 1998 Employment Agreement, Leung was to receive as compensation a base salary, an incentive bonus, and vacation pay. (ER 143-45, 157-58) Including the automatic renewal period, the term of Leung's Employment Agreement was also for eight years. (ER 142) Leung's agreement similarly provided that in the event of a termination without cause, she would receive a lump-sum severance payment based upon a multiple of her base salary. (ER 148-49)

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[1] Citations in the form "ER __" are to the Excerpts of Record filed by Petitioners in the Ninth Circuit.

In July 2000, GIGL and TV-Guide International, Inc. ("TV Guide") merged to form Gemstar. (ER 15-16) Following the merger, Yuen entered into a Stockholder's Agreement with The News Corporation Limited ("News Corp."), TV Guide's largest stockholder and, following the merger, a 42 percent shareholder of Gemstar. Under the Stockholder's Agreement, Yuen and Leung were guaranteed their positions at Gemstar under their Employment Agreements until 2005. (ER 16.) The agreement also provided that overall control over management and direction of the company would be divided equally between Petitioners and News Corp., with Yuen and News Corp. each having the power to appoint half of Gemstar's board of directors. (ER 16)

By the summer of 2002, a serious disagreement over the strategic direction of the company had developed between Petitioners and News Corp. The dispute focused on one of the principal products offered by Gemstar, its Interactive Program Guide ("IPG"), an interactive, on-screen electronic television guide that enables viewers to scan, sort and preview programs on hundreds of cable and TV channels. (ER 16) Yuen and Leung saw the IPG as a significant source of revenue for Gemstar itself, both through licensing fees from the cable and satellite operators who would implement the IPG on their systems, and from advertising revenue generated by ads placed on the IPG. (ER 16) News Corp., on the other hand, sought to use the IPG as a means of increasing the reach and distribution of its other cable products, such as Fox Sports or Fox News Channel. News Corp. wanted to greatly reduce the IPG licensing revenue generated from cable and satellite operators, in exchange for their agreement to carry News Corp. channels. (ER 16-17) These divergent visions of the company's future resulted in corporate gridlock at Gemstar. (ER 17)

In an effort to unblock the impasse affecting the company's operations, News Corp. and Petitioners entered into restructuring negotiations. An agreement was ultimately reached pursuant to which Yuen and Leung would resign their positions as CEO and CFO; Yuen would relinquish his right to appoint half the Gemstar board; and News Corp. would become majority, and controlling, shareholder. (ER 17) As consideration for relinquishing their managerial positions and control over the operation of the company, Yuen and Leung were to receive payments due them under their employment agreements for terminations without cause. (ER 17)

Also under the restructuring, both Petitioners were to receive a termination, or severance, payment. Although those severance payments were based on the formulas set forth in the Employment Agreements, the Petitioners agreed to a substantial reduction of the final amounts due. Thus, under the restructuring agreement, Yuen was to receive a severance of $22.45 million, voluntarily reduced from the $37.31 million otherwise due Yuen for a termination without cause under his Employment Agreement. (ER 17) Leung was to receive $6.96 million of severance under the restructuring, reduced from the $7.07 million due Leung under her Employment Agreement for a termination without cause. (ER 17-18)

In addition to the severance payments, each Petitioner, as of the time of the restructuring negotiations, was owed certain accrued and earned, but unpaid, compensation items, consisting of salary and bonuses. (ER 18-19) Petitioners also were owed under their agreements earned, but unpaid, vacation pay.

The total payments due to Petitioners under the restructuring agreements were as follows:

Henry Yuen

Termination Fee	$22,452,640
Unpaid Items:	
Vacation	$ 1,921,870
Salary	$ 1,028,489
Bonus	$ 4,080,418
Total Items:	$ 7,030,777

Total Payments $29,483,417

(ER 307-12)

Elsie Leung

Termination Fee	$ 6,957,953
Unpaid Items:	
Vacation	$ 474,406
Salary	$ 191,231
Bonus	$ 544,058
Total Items:	$ 1,209,695

Total Payments $ 8,167,648

(ER 307-12)

Contemporaneous with the restructuring negotiations, the SEC commenced an informal investigation of Gemstar. Then, on October 17, 2002, the SEC issued a formal order of investigation of Gemstar. (ER 21) On November 6, 2002, Gemstar advised Petitioners that they would not immediately receive the agreed-upon restructuring payments, which, at the SEC's direction, Gemstar would deposit into segregated accounts for a six-month period. (ER 21-22) At the conclusion of the six months, if no agreement had been reached between the SEC and petitioners as to the disposition of these payments, the payments were to be disbursed to Petitioners immediately. (ER 29, 33)

Proceedings In The District Court

On May 5, 2003, one day before the funds were to be released to Petitioners, the SEC applied to the District Court for a freeze order pursuant to Section 1103. The District Court exercised subject matter jurisdiction pursuant to Section 1103.

On June 20, 2003, the District Court issued a decision granting the SEC application for a freeze. (ER 355-77) In its decision, the court acknowledged that the text of Section 1103 was "unclear" and "inadequate" (ER 365), and also acknowledged that Petitioners' interpretation of "extraordinary payments" as improper corporate payments was colorable. (ER 363) Ultimately, however, the District Court determined that the payments at issue should be deemed "extraordinary payments" because (i) they were the product of substantial negotiation; (ii) the payments were made in connection with Yuen and Leung's departure from senior management, an event that was disclosed an 8-K filing, and (iii) the payments were "large." (ER 372-73) The temporary freeze was extended indefinitely when the SEC filed an enforcement action against Petitioners and others in June 2003. (ER 378-379)

Proceedings On Appeal

Yuen and Leung appealed the escrow order and, on May 12, 2004, a panel of the Ninth Circuit reversed the district court. The panel determined that the district court erred when it concluded that the restructuring payments were "extraordinary payments." Finding that "proof by admissible objective evidence of what is ordinary is necessary . . . to determine what is extraordinary" (39a), the panel thoroughly examined each of the three bases relied on by the district court and held that the first two were "irreducibly subjective" conjecture

and the third basis was simply erroneous as a matter of logic. (37a) The Court stated:

> First, the district court found that the negotiation of the termination agreements for Appellants was "extraordinary". . . . *[but] [n]othing in the record suggests this extended negotiation constitutes a deviation from the norm for corporate decision-making of this type* . . . .
>
> [S]econd . . . the district court based its finding that the proposed payments were "extraordinary payments" [because of] their size . . . *[but] [t]here is no evidence in the record of what similarly placed officers and board members of corporations of similar revenues and worth are paid upon termination* . . . .
>
> Last, the district court found it significant that after the termination contracts were finalized, defendant Gemstar chose to report the terms in a Form 8-K filing . . . . *But, a discretionary corporate disclosure is not an admission that the company has paid an "extraordinary" amount.*

(33a-36a) (emphasis added).

The Court then concluded that the escrow order had not been "guided by precepts of proportionality and precedent," and that any "reasonable interpretation of the common meaning of Section 1103 requires that the questioned payments be out of the ordinary." (38a-39a) Because no objective evidence had been adduced in the district court that the payments were out of the ordinary, the panel reversed the judgment. (39a)

On March 22, 2005 the Ninth Circuit, sitting *en banc*, set aside the panel decision. The court stated:

> "Extraordinary" means, in plain language, out of the ordinary. In the context of a statute aimed at preventing the raiding of corporate assets, "out of the ordinary" means a payment that would not typically be made by a company in its customary course of business. The standard of comparison is the company's common or regular behavior. Thus, the determination of whether a payment is extraordinary will be a fact-based and flexible inquiry. Context-specific factors such as the circumstances under which the payment is contemplated or made, the purpose of the payment, and the size of the payment may inform whether a payment is extraordinary, as the district court properly noted in this case. For example, a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances. See BLACK'S LAW DICTIONARY 586 (6th ed. 1990) (defining "extraordinary" as "[o]ut of the ordinary; . . . . employed for an exceptional purpose or on a special occasion").
>
> A nexus between the suspected wrongdoing and the payment itself may further demonstrate that the payment is extraordinary, although such a connection is not required. Evidence of the company's deviation from an "industry standard"—or the practice of similarly situated businesses—also might reveal whether a payment is extraordinary. Again, however, the statute does not compel any specific method of making the determination but allows for the consideration of a variety of factors, as the situation may warrant.

(92a-94a) (footnote omitted). The court provided no guidelines for interpreting Section 1103, stating only that in determining whether a payment is "extraordinary" one must consider "(1) the circumstances of the pay-

ment, (2) the purpose of the payment, and (3) the size of the payment." (94a)

The author of the panel decision, Judge Bea, filed a dissent. Judge Bea pointed out that the majority erroneously interpreted the phrase "extraordinary payments" to mean "payments under extraordinary circumstances." (105a). The dissent explained:

> [T]he majority has not so much interpreted the statute as it has rewritten it. As explained above, the majority's interpretation of "extraordinary payments" amounts to "payments under extraordinary circumstances." See Maj. Op. at 3417-20. Indeed, the majority itself explains that "a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances." *Id.* at 3418. Thus, under the majority's interpretation, *any* payment following "extraordinary circumstances" may be subject to escrow. Yuen and Leung could have been paid $1 or 1 billion—it would make no difference to the majority.

(109a).

The dissent also demonstrated that the "circumstances" relied upon by the majority, which included revenue restatements, a securities fraud investigation, significant declines in Gemstar's stock price, and a public relations crisis, could not, in themselves, render the payments at issue "extraordinary:"

> Some of these factors are certain to be present anytime the SEC investigates a company for possible violations of the federal securities laws, and the rest are likely to be present. . . . By defining "extraordinary" to mean little if anything more than that circumstances exist that might give cause to the SEC to initiate a lawful investigation, "extraordinary"

> serves no independent modifying propose. Each payment made in the midst of circumstances likely to lead to an SEC investigation becomes made under "extraordinary circumstances," therefore an "extraordinary payment."

(111a).

Apart from being inconsistent with the language of the statute, the dissent found the majority's approach to raise substantial practical concerns. According to the dissent:

> [E]ven had the majority not rewritten the statute and, indeed, written the very term at issue out of the statute, its interpretation is unworkable as a practical matter. The majority first interprets "extraordinary payments" as those "that would not typically be made by a company in *its* customary course of business," Maj. Op. at 3417 (emphasis added). Thus, as the majority explains, "[t]he standard of comparison is *the company's* common or regular behavior." *Id.* (emphasis added). This alone raises a significant practical concern. Presumably, terminating the CEO's and CFO's employment is never done "by a company in *its* customary course of business." *Id.* (emphasis added). I think we can all agree that these events do not occur, for any given business, each Monday morning as the doors open for business. Does this mean, then, that any payment to a departing CEO, CFO or, for that matter, any officer or director may be subject to escrow? . . . . Can this really be what Congress meant by "extraordinary"?

(112a-113a.)

The dissent summarized its view as follows:

> Section 1103 empowers the SEC to escrow "extraordinary payments," not payments made under extraordinary circumstances, particularly where

> "extraordinary circumstances" means little if anything more that that the company is under investigation for securities violations. Further, if it is to be a workable standard, the relevant comparison must be not to the company at issue, but to other comparable companies, under circumstances which have not resulted in an investigation by securities agencies, but which are otherwise comparable. Because the SEC failed to adduce any such relevant evidence, I would vacate the district court's order and permit the SEC the opportunity to do so.

(123a)

REASONS FOR GRANTING THE WRIT

The SEC has used a strained and erroneous interpretation of Section 1103 to freeze Petitioners' assets without showing that the payments at issue were "extraordinary payments" in any respect and without showing that the payments were wrongfully derived. The Ninth Circuit's construction of Section 1103, which affirmed the SEC's position, represents a significant misreading of the statute and the congressional intent underlying the act. If left uncorrected, this interpretation will permit the SEC to freeze any payments to be made to corporate executives once an SEC investigation has commenced, and will thus provide the SEC with unintended and dangerous leverage over individuals who seek nothing more than their lawful entitlements. Indeed, in this case, the SEC capitalized on the ambiguity inherent in the statute to mislead Petitioners about the SEC's intended application of the statute, thereby achieving a two-year asset freeze without having to present any evidence that the frozen payments were "extraordinary payments." The proper construction of Section 1103 is an

important question of federal law that will assist in defining the appropriate limitations on the powers of federal agencies, and "that has not been, but should be, settled by this Court." Supreme Court Rule 10(c).

I. BY PERMITTING A PRE-COMPLAINT FREEZE OF CONTRACTUALLY-BASED ENTITLEMENTS WITHOUT REQUIRING A SHOWING THAT THE PAYMENTS ARE EXCESSIVE OR UNUSUAL AS COMPARED TO SIMILAR PAYMENTS, OR THAT THEY ARE IN SOME RESPECT IMPROPER, THE NINTH CIRCUIT HAS RENDERED THE MODIFIER "EXTRAORDINARY" SUPERFLUOUS AND HAS DISREGARDED THE PURPOSE OF THE STATUTE

By using the term "extraordinary payments" in Section 1103, Congress plainly sought to limit in a significant fashion the class of payments subject to a pre-complaint freeze by the SEC, even where the SEC was investigating the individuals to whom the payments were to be made. In shifting the focus away from the payment itself and to the circumstances surrounding the payment, the Ninth Circuit improperly and unreasonably expanded the scope of Section 1103 to encompass *any* payment to be made by a company under investigation by the SEC. Citing revenue restatements, a falling stock price, and a public relations crisis surrounding Gemstar during the relevant period, the Ninth Circuit relied solely upon circumstances that are certain to be present *every time* an SEC investigation is commenced. (110a-111a) But, because Section 1103 requires *both* the existence of an SEC investigation *and* "extraordinary payments," something more than the circumstances justifying the commencement of a SEC investigation necessarily must be adduced in order to invoke Section 1103. (111a)

Indeed, the text and the legislative history of Section 1103 require that at least two factors be present. First, even the common meaning of "extraordinary" requires the SEC to come forward with objective evidence, based on past practices of similarly situated companies, as to what is ordinary and what is out of the ordinary. As the dissent below stated: "I must interpret 'extraordinary payments' to mean payments not usual or ordinary relative to those made by other comparable companies, under circumstances which have not resulted in an investigation by securities agencies, but are otherwise comparable." (115a) Under such a standard, payments of the type involved herein—i.e., contractually-based severance, vacation, bonuses, salary—would only be subject to seizure if they were shown, by objective, admissible evidence, to be truly "extraordinary" based on historic practices of comparable, similarly situated companies. As the dissent also observed, "extraordinary" is an inherently comparative concept, and thus requires a baseline of what is ordinary in a similar situation. The Ninth Circuit's interpretation required no such showing, nor was any such evidence adduced in the District Court. Thus, the payments at issue have been frozen for two years without the SEC even being required to establish the one and only substantive element found in Section 1103.

Second, the purpose of Section 1103, as reflected in the legislative history, also requires a showing that the payments were "improper" or "illegitimate" in some proven respect. In interpreting a significant piece of federal legislation such as the Sarbanes-Oxley Act, a court must be guided by the underlying purpose that led to congressional action. Singer, Norman, Sutherland, *Statutory Construction*, §45:09 (2000) (noting that "to determine legislative intent the court should look to the apparent statutory purpose as disclosed by the language

in light of the legislative history" and that "the primary task of the court when construing a statute is to attribute to the enactment the meaning most consistent with its policies and with the obvious purpose of the legislature, by viewing the statute in light of the circumstances that motivated its passage") (citations omitted).

In the case of the Sarbanes-Oxley Act, the circumstances giving rise to its enactment plainly reflect an intent to freeze or limit payments that are illegitimate or unwarranted. As the Ninth Circuit itself noted, Sarbanes-Oxley was the result of highly publicized and disturbing events in the American corporate world, in which our nation was "[f]aced with one cataclysmic corporate accounting scandal after another, including Enron, WorldCom, and Tyco." (72a) Section 1103 was "[e]nacted in the disturbing shadow of a flood of corporate scandals, its purpose is to temporarily protect corporate funds and the investing public and creditors against theft, fraud and dissipation." (71a-72a) It was a desire to limit or restrict payments infected with such impropriety that drove the passage of Section 1103.

The legislator who initially introduced Section 1103 (as Amendment No. 4188, see 148 Cong. Rec. S6542) was Senator Trent Lott. Senator Lott explained that Section 1103 was a response to specific wrongdoing. Senator Lott stated that the section "freezes payments of potential wrongdoers. This section would allow the SEC, during an investigation, to seek an order in Federal court imposing a 45-day freeze on extraordinary payments to corporate executives. Again, this year we have seen just that sort of thing happening. While an investigation [was] underway, basically rewards were given to these corporate executives." Senator Lott added that, if enacted, Section 1103 would ensure that corporate funds are not "improperly taken" for an "executive's personal

benefit," and would protect against "increased payments, extraordinary payments" being made during SEC investigations. 148 Cong. Rec. S6545 (2002).

As the sponsor of Section 1103, Senator Lott's comments on the purpose underlying the section are instructive, and are entitled to substantial consideration in construing the statute. *Galvan* v. *Press*, 347 U.S. 522, 526-27 (1954); *United States* v. *United Mine Workers of America*, 330 U.S. 258, 279-80 (1947); *United States* v. *Wrightwood Dairy Co.*, 315 U.S. 110, 125 (1942). But Senator Lott was not the only Senator to specifically refer to Section 1103 as intended to reach improper payments. Senator Hatch stated: "In particular, these provisions would enable to [sic] SEC to freeze *improper payments* by obtaining a federal court order." 148 Cong. Rec. S6550 (2002) (emphasis added).

Similar sentiments were expressed in the House debate over the bill. Congressman James Sensenbrenner stated that under Section 1103, executives will not be allowed to "pilfer the assets of the company by giving themselves huge bonuses and other extraordinary payments" during an SEC investigation. 148 Cong. Rec. H4685 (2002). Congressman Sensenbrenner continued, "Americans will know that corporate officers will no longer be able to misuse the bankruptcy laws to discharge liabilities based upon securities fraud, and the honest brokers of corporate America will know that those who abuse the law and tarnish corporate America's reputation will go to jail for a long, long time." *Id.*

The legislative history further demonstrates that a principal purpose of the freeze was to permit a review of "whether such payments were warranted or not." 148 Cong. Rec. H4687 (2002). Or, as Senator Biden noted, Section 1103 was a "45-day freeze . . . based upon the SEC being able to hold [it] in escrow and freeze it for 45

days *while they look at it*." 148 Cong. Rec. S6546 (2002) (emphasis supplied). Such an inquiry is necessary only if the targeted payments are presumed to be improper or questionable in some way that can be ascertained within a short period of time.

Finally, it is significant that, when President Bush outlined the legislative proposal that later became Sarbanes-Oxley, he called on Congress to strengthen the SEC's ability to temporarily freeze "improper" payments. *See* John Bostleman, *The Sarbanes-Oxley Deskbook*, § 13.6.2 (2003) (citing Press Release, President George Bush (July 9, 2002), *www.whitehouse.gov/ news/releases/ 2002/07/20020709-4.html*).

The *en banc* decision of the Ninth Circuit misinterpreted this legislative history. The Court made no inquiry to determine whether the payments to Yuen or Leung were the product of "theft, fraud and dissipation," were "increased payments" or "improper payments," or constituted the "pilfering" of Gemstar assets. Instead, the Court stated that it was only required to examine the circumstances surrounding the making of the payments and the size of the payments in determining whether a payment should be considered "extraordinary." (94a) These boundless and amorphous inquiries resulted in an interpretation of Section 1103 that is completely untethered from the purposes that underlie it. They did not require any showing that that payments were actually extraordinary as compared to similar such payments, nor do they require any showing that the payments were improper or unwarranted. In fact, the opposite was established here. The payments were a series of contractually based entitlements, which were substantially reduced from what was owed, and that had been reviewed and ultimately approved by Gemstar's Board of Directors after a five-month period of negotiations.

There was no evidence adduced that severance packages for the CEO and CFO of large-scale media and technology companies were unusual, or even were unusual at Gemstar. And there certainly was no evidence adduced that Petitioners failed to perform under their Employment Agreements or that the payments otherwise lacked consideration.

The lower court's application of the statute to the contractually based payments thus represents an extension of the statute far beyond its stated reach, providing the SEC unintended and absolute leverage over individuals under investigation.

For these reasons, a writ of certiorari must issue and the Ninth Circuit's judgment must be vacated.

II. SECTION 1103 VIOLATES THE FOURTH AMENDMENT BY PERMITTING A PRE-COMPLAINT ASSET FREEZE BY THE SEC WITHOUT REQUIRING A SHOWING OF PROBABLE CAUSE OR REASONABLE SUSPICION OF WRONGDOING BY THE OWNERS OF THE SEIZED ASSETS OR A NEXUS BETWEEN THE SEIZED ASSETS AND THE ALLEGED WRONGDOING

As interpreted by the Ninth Circuit, Section 1103 permits the SEC to obtain a freeze of assets merely upon a showing that an investigation has been commenced by the SEC. There is no requirement that the SEC even allege wrongdoing by the owners of the assets or that the assets be in anyway derived from, the product of, or connected to, wrongful conduct. There is no requirement of a showing of probable cause or even reasonable suspicion to justify a seizure. There is no requirement that a civil enforcement action be commenced or pending—it is simply the circumstance that a company is being *investigated*

that serves as the predicate for the Commission to freeze assets.

This sweeping grant of power represents an unprecedented expansion of the SEC's authority to obtain a judicial freeze of assets. When the SEC seeks a traditional judicial asset freeze under the Exchange Act or through an invocation of the court's equitable authority, courts typically require a factual showing that the underlying claims are meritorious, *SEC* v. *Cavanagh*, 155 F.3d 129, 132 (2d Cir. 1998), and that there is a legitimate concern that the assets sought to be frozen will be dissipated absent a freeze. *See SEC* v. *Gonzalez de Castilla*, 145 F. Supp. 2d 402, 415 (S.D.N.Y. 2001). Courts also have considered the hardship that would be imposed upon the defendant if the freeze is granted, *SEC* v. *Householder*, 2002 WL 1466812, at *8 (N.D. Ill. July 8, 2002), whether the freeze is "narrowly tailored" to ensure that it does not interfere with legitimate business conduct, *SEC* v. *American Bd. of Trade, Inc.*, 645 F. Supp. 1047, 1050 (S.D.N.Y. 1986), *aff'd*, 830 F.2d 431 (2d Cir. 1987), and whether the amount of assets to be frozen exceeds the amount that could potentially be recovered by the SEC at the conclusion of a successful action. *SEC* v. *Bremont*, 954 F. Supp. 726, 733 (S.D.N.Y. 1997); *see also SEC* v. *Hickey*, 322 F.3d 1123, 1131 (9th Cir. 2003) (freeze was justified where it was "necessary to give life to" previously entered disgorgement and contempt orders). Furthermore, in the context of traditional asset freezes, "[c]ourts generally frown upon asset freezes of unlimited duration." *SEC* v. *Healthsouth Corp.*, 261 F. Supp. 2d 1298, 1325 (N.D. Ala. 2003) (citing SEC v. *Unifund SAL*, 910 F.2d 1028, 1042-43 (2d Cir. 1990)). As one court stated, "the decision to order a temporary freeze on defendants' assets . . . requires particularly careful consideration by the district court." *SEC* v.

Manor Nursing Centers, Inc., 458 F.2d 1082, 1105 (2d Cir. 1972).

In stark contrast, Section 1103 authorizes a pre-complaint freeze, and requires only that it "appears to the Commission" that an "extraordinary payment" is about to be made by an issuer. There is no substantive standard that the SEC must meet to obtain a 45-day asset freeze, much less the sort of objective and non-arbitrary determination that should be required before a deprivation, even a temporary one, of any property occurs. This statutory scheme violates the Fourth Amendment's prohibition against unreasonable seizures.

The Fourth Amendment protects "[t]he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures," and provides that such rights "shall not be violated . . . . but upon probable cause." This court has explained that a "seizure" of property within the meaning of the Fourth Amendment occurs when "there is some meaningful interference with an individual's possessory interests in that property." *United States* v. *Jacobsen*, 466 U.S. 109, 113 (1984). A temporary asset freeze constitutes a "seizure" under the Fourth Amendment. *See Colello* v. *SEC*, 908 F. Supp. 738, 752-53 (C.D. Cal. 1995) (SEC conceded, and court found, that asset freeze at issue "constitute[d] a 'seizure' within the meaning of the Fourth Amendment"); *see also Andrews* v. *Crump*, 984 F. Supp. 393, 410 (W.D.N.C. 1996) (finding that tax lien under state law "was a meaningful interference with possessory interests and, thus, a Fourth amendment seizure"). Thus, the SEC's effort to freeze petitioners' assets qualifies as a "seizure" under the Fourth Amendment.

As a general matter, a seizure is unreasonable absent a showing of probable cause that an offense has been committed. *See Colello*, 908 F. Supp. at 753. *Andrews*,

984 F. Supp. at 411. In *Colello*, the SEC froze the plaintiff's assets in Switzerland pursuant to a treaty that allowed for such seizures based on the government's "reasonable suspicion." *Colello*, 908 F. Supp. at 753. The plaintiff filed suit, arguing that the asset freeze was an unreasonable seizure in violation of the Fourth Amendment. The court agreed, rejecting the SEC's arguments that important law enforcement needs justified a "reasonable suspicion" standard. *Id.* at 754-55. Instead, the court held that the constitution demanded that the SEC show probable cause before freezing the plaintiff's assets. *Id.* at 754.

The Ninth Circuit ignored the principles set forth in *Colello*, the only case that directly addresses the Fourth Amendment issues implicated by asset seizures, and rejected Petitioners' Fourth Amendment challenge with barely any analysis, relying upon this Court's decision in *New York* v. *Burger*, 482 U.S. 691 (1987). Yet *Burger*, a case that was not cited or argued by the SEC, provides no support for dispensing with probable cause when the government seeks to deprive an individual of property for months or years at a time. In *Burger*, this Court addressed a Fourth Amendment challenge to brief, unannounced *searches* performed pursuant to a complex administrative statutory scheme that regulated automobile dismantlers. Moreover, the searches in *Burger* were sustained only because (i) vehicle dismantlers' businesses are highly regulated, and therefore those business have a reduced expectation of privacy, and (ii) the statute at issue in that case provided a "constitutionally adequate substitute for a warrant" because the "time, place and scope" of the searches was limited. *Burger*, 482 U.S. at 702-712. Petitioners' privacy interests, of course, have nothing to do with this case, and the property interest that they have in the restructuring payments is not "reduced." Accordingly, the first justification for

Burger's holding is not present here. In addition, Section 1103, especially as interpreted by the Ninth Circuit, provides no limits at all as to the types of payments that may be subject to a freeze once the SEC commences an investigation. It therefore provides no "constitutionally adequate substitute for a warrant"—if the warrant requirement is to have any meaning at all.

Because Section 1103 does not require a showing of probable cause that an offense has been committed or that the assets to be frozen are connected to such an offense, it violates the Fourth Amendment.

III. SECTION 1103 IS VOID FOR VAGUENESS AS APPLIED TO PETITIONERS BECAUSE THE SEC MISLED PETITIONERS AS TO THE SEC'S INTENT TO APPLY THE STATUTE TO THE RESTRUCTURING PAYMENTS

Section 1103 is unconstitutionally vague as applied to Petitioners. Section 1103 was passed in July 2002, during Yuen and Leung's negotiations concerning the restructuring payments. After the negotiations were concluded, in early October 2002, the SEC was informed by Gemstar of the precise size, nature and makeup of the restructuring payments to be paid to Petitioners. (ER 307-312.) Upon receiving this information, the SEC told Petitioners that, because the scope and reach of Section 1103 was at that time unclear, the SEC had not determined whether the restructuring payments would constitute "extraordinary payments" under the statute. Thereafter, and still prior to the closing of the restructuring in November 2002, the SEC appeared to admit that at least the vacation pay component of the restructuring payments would not be deemed an "extraordinary payment." (ER 19-21.) The SEC did not clarify its position on the breadth of Section 1103 before the restructuring closed on November 7, 2002.

Faced with a statute of uncertain scope and no guidance from the SEC or otherwise, Petitioners finalized the restructuring, only to be confronted—six months later—with a Section 1103 application claiming that *all* of the restructuring payments should be frozen based upon arguments and facts that the SEC had at their disposal in October 2002. Specifically, the SEC argued that the restructuring payments were "extraordinary payments" because (i) they were based upon Petitioners' employment contracts, which included incentive provisions, (ii) they were the subject of extensive negotiation, and (iii) they were multiples of Petitioners' salaries. Yet, the SEC cannot fairly be permitted to rely upon factors which it claims so clearly rendered the payments "extraordinary" in May of 2003, but which existed and were known to the SEC in October 2002, when Petitioners were deciding whether to close the restructuring and the SEC professed to be uncertain as to the application of Section 1103. Indeed, to permit the SEC to unfairly capitalize on the ambiguity inherent in Section 1103 in this fashion would be to countenance pure arbitrariness in the enforcement of federal law.

These circumstances are closely analogous to those in *Chalmers* v. *City of Los Angeles*, 762 F.2d 753 (9th Cir. 1985), a case in which a vagueness challenge to an economic regulation was sustained. In *Chalmers*, a street vendor was faced with two patently conflicting ordinances regulating when and where she was permitted to sell her goods. *Id.* at 758. Faced with this ambiguity, Chalmers "sought both to consult relevant legislation in advance of her action and to clarify the meaning of the regulation by resort to City officials." *Id.* Notwithstanding this consultation, the City Attorney told Chalmers he was "not certain of the ordinances' meanings." *Id.* When Chalmers nonetheless decided to vend her wares, the City applied one of the two ordinances to

punish her. The court held that the city's ordinances were vague as applied, concluding that the "due process violation occurred in the manner in which this inconsistent scheme was implemented and enforced." *Id.*

Here, as in *Chalmers*, Petitioners were faced with an ambiguous business regulation, and unsuccessfully sought guidance from the government agency charged with the law's enforcement. After guidance was withheld and Petitioners finalized the restructuring, the SEC took advantage of the ambiguity and brought the full force of the statute down upon them. This arbitrary application of the new statute made it impossible for Petitioners to order their activities in a way that would not run afoul of the law. It therefore cannot be sustained under the due process clause.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be granted.

Dated: June 20, 2005
New York, New York

Respectfully submitted,

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE No. CV 03-03124 MRP
Filed June 20, 2003

SECURITIES AND EXCHANGE COMMISSION

Applicant,

—v.—

GEMSTAR-TV GUIDE INTERNATIONAL, INC.,

Respondents.

MEMORANDUM OF DECISION RE: AN APPLICATION FOR A TEMPORARY ORDER PURSUANT TO SECTION 1103 OF THE SARBANES-OXLEY ACT

I. Introduction

Section 1103 of the Sarbanes-Oxley Act ("Section 1103"), 15 U.S.C. § 78u-3(c)(3), empowers the Securities and Exchange Commission ("SEC" or "Commission") to apply for a court ordered escrow for up to 90 days of any "extraordinary payments" that an issuer seeks to make to its officers while under investigation

for possible securities law violations. Section 1103 provides:

> Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

15 U.S.C. § 78u-3(c)(3)(A)(i). The temporary order may be entered "only after notice and opportunity for a hearing," unless such procedures would be "impracticable or contrary to the public interest." 15 U.S.C. § 78u-3(c)(3)(A)(ii).

Section 1103 further provides that the temporary order "may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days." 15 U.S.C. § 78u-3(c)(3)(A)(iv).

II. Background

A. Factual Background

Gemstar-TV Guide International, Inc. ("Gemstar" or "Company") is a Delaware corporation with offices in Pasadena, California. It is also the subject of an ongoing SEC investigation as well as the defendants in numerous class action suits filed by Gemstar shareholders.

Dr. Henry Yuen was, until November 2002, Gemstar's Chief Executive Officer ("CEO"). Elsie Leung served as Gemstar's Chief Financial Officer ("CFO"), co-President, and co-Chief Operating Officer until November 2002. Yuen and Leung are hereinafter referred to as the "Intervenors."

According to the various allegations, the Company violated federal securities laws between June 2000 and April 2002 by recognizing millions of dollars of revenue in violation of Generally Accepted Accounting Principles. Specifically, Gemstar is alleged to have improperly recognized revenue from an expired licensing agreement with Scientific-Atlanta, Inc. ("Scientific-Atlanta"). Additionally, the Company is alleged to have improperly recognized revenue in connection with its acquisition of certain assets of Fantasy Sports Properties, Inc. ("Fantasy Sports").

In April 2002, Gemstar filed its annual report on Form 10-K for fiscal year-ended December 31, 2001 wherein it disclosed that it had recognized the Scientific-Atlanta revenue as well as $20 million in advertising revenues based on the nonmonetary barter transaction with Fantasy Sports. On June 27, 2002, the SEC issued Order No. 4-460, which required Yuen and Leung to file with the SEC a statement in writing, under oath, declaring that Gemstar's most recent Form 10-K and any Form 8-K filed subsequent thereto: (i) do not contain any untrue statement of material fact; (ii) do not omit to state a material fact necessary to make the statements made in the SEC filings not misleading; and (iii) have been reviewed with the Company's audit committee, or in the absence of an audit committee the independent members of the Company's Board of Directors. Yuen and Leung refused to certify the accuracy of Gemstar's financials as

required by Order No. 4-460. Gemstar subsequently restated its prior financial results.

The market and the SEC reacted negatively to this chain of events. Thereafter, Yuen, Leung, and Gemstar reached an agreement whereby Yuen and Leung would step down from their positions as officers of Gemstar.

Through a series of heavily negotiated agreements intended to terminate their employment, Gemstar attempted to award Yuen over $40 million in cash and stock options, restricted stock, and stock units for approximately 14.5 million shares of Gemstar stock, and attempted to award Leung approximately $10 million in cash and stock options, restricted stock, and stock units for 2.3 million shares of Gemstar stock. The total monetary compensation ("Cash Payments") to be distributed to Yuen and Leung are described and apportioned in two "Termination Agreements" entered into on November 7, 2002 as follows:

	Yuen	Leung
Termination fee	$22,452,640	$6,957,953
Unpaid salary, bonus, and vacation[1]	$7,030,778	$1,209,695
TOTAL	$29,483,418	$8,167,648

For their part, Yuen and Leung provided Gemstar with certain releases (Arkin Decl. Ex. A at 9-11, Ex. B at 9-11) and made representations and warranties as to the accuracy of certain former Gemstar filings with the SEC (Arkin Decl. Ex. A at 17-18, Ex. B at 14-15). Additionally, Yuen and Leung resigned as officers and directors of Gemstar. (Arkin Decl. Ex. A at 1-2, Ex. B at 1-2.)

[1] The Intervenors refer to this portion as "Unpaid Accrued Items."

As part of the restructuring process, Yuen and Leung also each entered into agreements with Gemstar (collectively, the "Side Letters" to place the Cash Payments in escrow until the earlier of: (i) May 6, 2003, or (ii) the SEC's agreement to release the funds.

B. Procedural Background

In a separate earlier action, *Yuen v. S.E.C.*, No. 03-2219 (C.D. Cal. filed Mar. 31, 2003), the Intervenors sought a preliminary injunction preventing the SEC from taking any further steps to thwart the distribution of the Cash Payments. Under their theory, the SEC, by coercing the execution of the Side Letters, had circumscribed the procedural protections and substantive limitations provided for by Congress in Section 11.03. In so doing, the SEC, working in conjunction with Gemstar, allegedly had violated Sections 706(2)(A), (B), (C), and (D) of the Administrative Procedures Act ("AAA"), § 5 U.S.C. § 551, et. seq.

The SEC disagreed with the Intervenors' characterization. It asserted that although the Commission informed counsel for Yuen and Leung and for Gemstar that it would seek a court order freezing extraordinary payments pursuant to Section 1103 and obtained an agreement from Gemstar to give the Commission seven days' notice before any termination payments were disbursed to Yuen or Leung, it did not have any input into the terms of the Side Letters between Gemstar, Yuen, and Leung.

In that earlier proceeding, Gemstar remained silent as to the chain of events leading up to the restructuring.

The court rejected the Intervenors' request for a preliminary injunction, finding that they were not likely to succeed on the merits of their contentions.

D. Motion Before the Court

The Commission filed this action seeking an order pursuant to Section 1103 to freeze any extraordinary payments by Gemstar to Yuen and Leung. Though the original action named only Gemstar as a defendants, Yuen and Leung, with the Court's permission, have now intervened as respondents pursuant to Local Rules 7-19 and Rule 24(a).

III. Legal Standard

Section 1103 sets forth two main requirements that must be met before the Commission is permitted to petition the Court for a temporary order. First, the petition must occur "during the course of a lawful investigation involving possible violations of the Federal securities laws." 15 U.S.C. § 78u-3(A)(i). Second, it must "appear" to the Commission that "it is likely that the issuer will make extraordinary payments." *Id.*

Congress did not explicitly set forth the Commission's burden in seeking a Section 1103 order. However, there appears to be no serious challenge here that the application is pursued in conjunction with a "lawful investigation" and that it is "likely" the Gemstar will make some payments to Yuen and Leung. Whether those payments are, in the statutory sense, "extraordinary," requires additional consideration, but the Court ultimately concludes that under almost any standard, the Commission has met its burden here.

IV. Discussion

A. The Meaning of "Extraordinary Payments"

The interpretation of Section 1103 appears to be an issue of first impression.[2] In interpreting Section 1103, as with the interpretation of any federal statute, the Court's goal "is to ascertain the intent of Congress and to give effect to legislative will." *United States v. Taylor,* 802 F.2d 1108, 1113 (9th Cir. 1986), *cert. denied,* 479 U.S. 1094 (1987). "Statutory interpretation begins with the plain language of the statute." *United States v. Mendoza,* 244 F.3d 1037, 1042 (9th Cir. 2001) (citation omitted). Unless exceptional circumstances dictate otherwise, judicial inquiry into the meaning of a statute is complete once the Court finds that the terms of the statute are unambiguous. *Burlington Northern R. Co. v. Oklahoma Tax Commission,* 481 U.S. 454, 461 (1987).

Looking first to the words of the statute, it is apparent that not every payment by an issuer is intended to be subject to Section 1103. If Congress had intended to grant the Commission authority to freeze all payments, it could have easily authorized the freezing of the broader term "payments," rather than the narrower term, "extraordinary payments." It is "a cardinal principle of

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[2] On March 19, 2003, Healthsouth Corporation ("Healthsouth") consented to the entry of an order to freeze extraordinary payments by Healthsouth in the Northern District of Alabama. *S.E.C. v. Healthsouth Corp.*, Litig. Release No. 18044, 2003 SEC LEXIS 656 (Mar. 20, 2003). The district court also simultaneously entered an order freezing substantially all the assets of Healthsouth CEO and Chairman Richard M. Scrushy. *Id.* It is unclear whether Scrushy voluntarily consented to the initial freeze of his assets or whether Healthsouth ever negotiated to provide "extraordinary payments" to him; but it is clear that the freeze on Scrushy's assets was not instituted pursuant to Section 1103.

statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *City of Los Angeles v. United States D.O.C.*, 307 F.3d 859, 870 (9th Cir. 2002) (quoting *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (internal quotation marks and citation omitted)).

The plain words of Section 1103 also reflect Congress's intent that "compensation" is within the scope of payments that may be frozen pursuant to the provision. While it is not immediately apparent whether Section 1103's use of "compensation" is meant to include or exclude different types of compensation—e.g., bonus, vacation pay, or salary—it seems clear that the mere fact that a payment is compensation for something cannot automatically exclude that payment from a freeze pursuant to Section 1103. Specifically, since "compensation" in common usage refers to a payment that is made in exchange for something else, *see, e.g., Webster's Ninth New Collegiate Dictionary* 268 (1984) ("something that constitutes an equivalent or recompense"), and since "compensation or otherwise" is subject to Section 1103, it surely cannot be the case that the mere fact that a payment was bargained for excludes that payment from a Section 1103 freeze.

Other portions of the statute require more effort to illuminate. Particularly relevant here, "extraordinary payments" is not a term defined in Section 1103. Neither the term "extraordinary payments" nor the word "extraordinary" is used anywhere else in the Sarbanes-Oxley Act. Nor has the Commission made any public comments or releases that endeavor to explain the term. The Court thus begins with the presumption that the legislative intent is reflected by the ordinary meanings of the words. *Russello v. United States*, 464 U.S. 16, 21

(1983) (quoting *Richards v. United States*, 369 U.S. 1, 9 (1962)).

The Commission argues a plain meaning interpretation that would broadly define "extraordinary payments." Citing *Black's Law Dictionary* and *Webster's New Universal Unabridged Dictionary* (SEC Mot. at 14-16), it argues that "extraordinary" in common parlance essentially means "out of the ordinary" or "unusual." Unusual, of course, is a comparative adjective that has meaning only in relation to what is "usual." Here, the Commission argues that the payments are unusual for two reasons. First, they were made to effect at least three extraordinary corporate events for Gemstar: the removal of Yuen as CEO, the removal of Leung as CFO, and the change of control of Gemstar from Yuen and Leung to others. Second, the Commission argues that the payments are extraordinary in size when compared with Yuen's and Leung's respective annual salaries. According to the SEC, the total payments are more than five times Yuen's and Leung's respective salaries.

The "plain meaning" definition proffered by the Intervenors is much narrower. Under their construction, a payment is not extraordinary unless it is (i) made without proper corporate approval, or (ii) cannot be traced to identifiable legal obligations or well-established corporate policies existing at the time that the SEC commenced its investigation. (Yuen Supp. at 6.) In other words, the Intervenors argue that unless a payment is essentially illegal (i.e., made without corporate approval) or gratuitous (i.e., no identifiable legal obligation), it cannot be an extraordinary payment subject to Section 1103.

Though they represent extreme ends of the spectrum of possible "plain meanings," the interpretations proffered by both the commission and the Intervenors are at

least colorable. To urge the reasonableness of their respective positions, each party also offers its own "presumption" as to how broadly or narrowly the statute should be read. For their part, the Intervenors argue that Section 1103 "is in the nature of an attachment," and thus, to the extent that the plain meaning of Section 1103 is susceptible to different readings, the reading with narrower effect is to be preferred. (Supp. Mem. of Yuen and Leung at 4.)

This argument is wrong. The cases relied upon by the Intervenors are predicated either on the equity powers inherent in the federal courts, *see, e.g, Rosen v. Cascade Int'l, Inc.*, 21 F.3d 1520, 1527-30 (11th Cir. 1994), or on California law, *see, e.g., Utley v. United States*, 404 F.2d 746, 752 (9th Cir. 1962). Even if Section 1103 effected a seizure, the Intervenors' attempt to import these standards into Section 1103 is flatly inconsistent with Rule 64's mandate that in such seizures of property "any existing statute of the United States governs to the extent to which it is applicable." Fed. R. Civ. P. 64; *see also Reebok Int'l v. Marnatech Enters.*, 970 F.2d 552, 558-59 (9th Cir. 1992); *S.E.C. v. Unifund SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990) (where SEC sought an asset freeze, holding that issuance need not be tested against state law standards and that remedy may be granted, even in circumstances where the elements required to support traditional injunction have not been established).

Moreover, as the Commission correctly points out, the Supreme Court has consistently stated that the Securities and Exchange Act of 1934 (" '34 Acts"), of which Section 1103 is a part,[3] should be construed "not technically and restrictively, but flexibly to effectuate its remedial

[3] Section 1103 is an amendment to Section 21C(c) of the Securities Exchange Act of 1934.

purposes." *S.E.C. v. Zandford,* 535 U.S. 813, 819 (2002) (quotation marks and citations omitted).

Furthermore, Section 1103's legislative history suggests that the section should be read broadly to satisfy Congressional purposes.[4] Section 1103 was initially introduced as Amendment No. 4188 by Senator Trent Lott. 148 Cong. Rec. S6542 (2002). In the debate which ensued after Amendment No. 4188's introduction, different Senators focused on various possible abuses that Section 1103 was meant to prevent, and none seemed to believe that Section 1103 should be limited to prevent only a particular type of abuse:

> Section 3 freezes payments of potential wrongdoers. This section would allow the SEC, during an investigation, to seek an order in Federal court imposing a 45-day freeze on extraordinary payments to corporate executives. Again, this year we have seen just that sort of thing happening. While an investigation is underway, basically rewards were given to these corporate executives. While it would require a court order, there would be this 45-day freeze. The targeted payments would be placed in escrow, ensuring that corporate assets are not improperly taken from [sic] an executive's personal benefit. . . . We have also seen that there are some cases where the law had some loopholes or where it was not timely or where it was not strong enough. One example, of course, is where there has been shredding. Another example is the very bad image of corporate executives taking increased payments,

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[4] Where, as here, the text of the statute is unclear or inadequate, and there is no case law on point, resort to legislative history in ascertaining Congressional intent is proper. *Ram v. I.N.S.*, 243 F.3d 510, 515 (9th Cir. 2001).

> extraordinary payments, while they are being investigated. You can't have that sort of thing.

Id. at S6545 (statement of Sen. Lott). Nothing in Senator Lott's statement suggested that Section 1103 was meant to prevent only those increased payments 1) that are made without corporate approval or 2) that are not pursuant to an existing legal obligation. Senator Dayton understood the provision to be a "45-day freeze on corporate executives' extraordinary income based upon the SEC being able to hold that in escrow and freeze it for 45 days while they look at it." *Id.* at. S6546. Likewise, Senator Hatch also outlined the provision in broad terms: "In particular, these provisions would enable to [sic] SEC to freeze improper payments by obtaining a federal court order. The order, which could last for 45 days and be extended upon a showing of good cause, would freeze extraordinary payments to corporate executives and require that such payments be escrowed." *Id.* at S6550.

Finally, statements in the House also suggest a flexible and broad scope:

> Under this legislation, top executives will not be allowed to pilfer the assets of the company by giving themselves huge bonuses and other extraordinary payments if the company is subject to an [sic] SEC investigation. Their pay and benefits are frozen when the investigation starts. Americans will know that corporate officers will no longer be able to misuse the bankruptcy laws to discharge liabilities based upon securities fraud, and the honest brokers of corporate America will know that those who abuse the law and tarnish corporate America's reputation will go to jail for a long, long time.

148 Cong. Rec. H4685 (2002) (statement of Rep. Sensenbrenner).

These statements, taken together with the Supreme Court's guidance that the '34 Act is to be liberally applied, convince the Court that Section 1103 should be applied in a flexible and broad manner. The fact that corporate approval was granted or that the payment is paid in part because of a prior legal obligation, while relevant to the inquiry, cannot automatically shelter such payment from Section 1103's reach.

Nor can there be one litmus test that determines what is or is not extraordinary payment; rather, Congress intended for the courts to look to a variety of factors to determine whether a payment is extraordinary. These factors may include, among others, the size of the payment, the circumstances under which a payment is made, and the purpose of the payment. Given the flexible approach taken by Congress, the determination of what constitutes an extraordinary payment must be determined on a case by case basis, and the Court should not endeavor to set forth guidelines for determining all future cases. As discussed below however, whatever the meandering boundaries of Section 1103 may be, the Court finds that the payments at issue fall squarely within them.

B. Void for Vagueness

As an alternative to the narrow interpretation they offer, the Intervenors also assert that Section 1103 is unconstitutionally vague. The due process clauses of the Fifth and Fourteenth Amendment guarantee individuals the right to fair notice of whether, their conduct is prohibited by law.[5] *See Colautti v. Franklin*, 439 U.S. 379,

[5] Since Section 1103 is part of a federal statute, the vagueness challenge is properly analyzed under the due process clause of the Fifth Amendment. At least with respect to a vagueness challenge,

390-91 (1979). Although only constructive rather than actual notice is required, individuals must be given a reasonable opportunity to discern whether their conduct is proscribed so they can choose whether or not to comply with the law. *Giaccio v. Pennsylvania,* 382 U.S. 399, 402-03 (1966). The doctrine, by requiring explicit standards for those who apply them, also serves to prevent impermissible delegation of basic policy matters to "to policemen, judges, and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory application." *Grayned v. City of Rockford,* 408 U.S. 104, 108-09 (1972); *Papachristou v. City of Jacksonville,* 405 U.S. 156, 162 (1972). Of course, statutes need not be written with "mathematical" precision, nor can they be so written. *Grayned,* 408 U.S. at 110.

A challenged statute enjoys a presumption of constitutionality, *see Baggett v. Bullitt,* 377 U.S. 360, 372 (1964), and where two alternative readings are possible, the reading that avoids constitutional invalidity is to be preferred, *see Gomez v. United States,* 490 U.S. 858, 864 (1989); *Crowell v. Benson,* 285 U.S. 22, 62 (1932).

The degree of specificity required of statutes varies depending on the subject matter being regulated and the punishments that may be meted out to violators. In this case, Section 1103 is not backed with the force of criminal sanctions and is thus subject to less exacting review. *See Forbes v. Napolitano,* 236 F.3d 1009, 1011 (9th Cir.

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however, the due process rights and requirements under the Fourteenth and Fifth Amendments are co-extensive, and the courts use the standards and analysis under both Amendments interchangeably. *See, e.g., United States v. Griefen,* 200 F.3d 1256, 1266 (9th Cir. 2000) (in a case analyzing vagueness of a federal statute, citing Supreme Court precedent analyzing a state law, *Kolender v. Lawson,* 461 U.S. 352 (1983)).

2000) (stating that where statute provides for criminal penalties, it is subject to more exacting review) (citing *Kolender v. Lawson*, 461 U.S. 352, 357 (1983)) .

Also, since Section 1103 implicates no First Amendment rights, the law requires less specificity of it. *Smith v. Goguen*, 415 U.S. 566, 573 (1914) ("Where a statute's literal scope . . . is capable of reaching expression sheltered by the First Amendment, the doctrine, demands a greater degree of specificity than in other contexts."). Moreover, where no First Amendment rights are at stake, facial challenges are not appropriate; rather the section "must be examined in the light of the facts of the case at hand." *United States v. Mazurie*, 419 U.S. 544, 550 (1974) (citation omitted). *See also United States v. Purdy*, 264 F.3d 809, 811 (9th Cir. 2001) ("Where, as here, a statute is challenged as unconstitutionally vague in a cause of action not involving the First Amendment, we do not consider whether the statute is unconstitutional on its face.") (citation omitted).

It is significant that Section 1103 is primarily targeted to acts committed by public corporations. "In the field of regulatory statutes governing business activities, where the acts limited are in a narrow category, greater leeway is allowed." *Papachristou*, 405 U.S. at 162 (citations omitted); *Village of Hoffman Estates v. Flipside, Hoffman Estates*, 455 U.S. 489, 498 (1982). Moreover, when evaluating economic legislation, the question is not whether a provision is vague as to the general public; rather, the question is whether a provision is vague to a "business person of ordinary intelligence." *Hoffman*, 455 U.S. at 501. Indeed, since Section 1103 applies only to issuers required to file periodic reports under the '34 Act, Section 1103's target audience likely has a higher level of sophistication than even the ordinary business person.

Finally, the nature of Section 1103's deprivation is not particularly severe or unforgiving. *See id.* at 498 ("The degree of vagueness that the Constitution tolerates . . . depends in part on the nature of the enactment."). Section 1103 empowers the SEC only to freeze assets temporarily, not to assume permanent title over those assets. A defendant loses legal title to those assets only if the SEC prevails in a separate action to enforce the Federal securities laws.

For those persons whose payments are potentially subject to a freeze pursuant to Section 1103, there should be little difficulty in understanding the acts that Section 1103 seeks to prevent. In Section 1103, Congress is clearly targeting the disbursement of certain payments while an investigation by the SEC is underway. The number of forms these payments may assume is constrained only by the boundless imaginations of issuers, executives, and their lawyers; however, the Court thinks it is clear what the statute "as a whole prohibits."[6] *Grayned*, 104 U.S. at 110.

This is not a case where "no standard of conduct is specified at all" in the statute, but is instead a case where the statute "requires a person to conform his conduct to an imprecise but comprehensible normative standard." *Smith*, 415 U.S. at 578 (quoting *Coates v. City of Cincinatti*, 402 U.S. 611, 614 (1971)). Especially considering that Section 1103 was intended to be used after the

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[6] There may be cases at the margins where the extraordinary blends into the ordinary. Such potential occurrences do not change the result here. Because Section 1103 is not vague in characterizing the payments at issue to the Intervenors as extraordinary, the Court need not consider whether any other application of Section 1103 might be vague and unconstitutional. *See Parker v. Levy*, 417 U.S. 733, 756 (1974) ("One to whose conduct a statute clearly applies may not successfully challenge it for vagueness.").

Commission has begun investigating a person or issuer for violations of the securities laws, to say that Congress must specifically delineate what an extraordinary payment is would be to vitiate the core purposes of Section 1103 by creating a situation where "too easy opportunities are afforded to nullify the purposes of the legislation." *Winters v. New York*, 333 U.S. 507, 525 (1948) (Frankfurter, J., dissenting). For these reasons, the Court finds that Section 1103 is not unconstitutionally vague.[7]

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[7] In *Jordan v. DeGeorge*, the Supreme Court reviewed various terms that have withstood void for vagueness challenges:

> The phrase "crime involving moral turpitude" presents no greater uncertainty or difficulty than language found in many other statutes repeatedly sanctioned by the Court. The Sherman Act provides the most obvious example, "restraint of trade" as construed to mean "unreasonable or undue restraint of trade," *Nash v. United States*, 229 U.S. 373 (1913). Compare other statutory language which has survived attack under the vagueness doctrine in this Court: "in excess of the number of employees needed by such licensee to perform actual services," *United States v. Petrillo*, 332 U.S. 1 (1947); "any offensive, derisive or annoying word," *Chaplinsky v. New Hampshire*, 315 U.S. 568 (1942); "connected with or related to the national defense," *Gorin v. United States*, 312 U.S. 19 (1941); "psychopathic personality," *Minnesota v. Probate Court*, 309 U.S. 270 (1940); "wilfully overvalues any security," *Kay v. United States*, 303 U.S. 1 (1938); "fair and open competition," *Old Dearborn Co. v. Seagram Corp.*, 299 U.S. 183 (1936); "reasonable variations shall be permitted, "*United States v. Shreveport Grain & Elevator Co.*, 287 U.S. 77 (1932); "unreasonable waste of natural gas," *Bandini Petroleum Co. v. Superior Court*, 284 U.S. 8 (1931); "political purposes," *United States v. Wurzbach*, 280 U.S. 396 (1930); "range usually occupied by any cattle grower," *Omaechevarria v. Idaho*, 246 U.S. 343 (1918).

Jordan v. De George, 341 U.S. 223, 231-32 n.15 (1951). These cases and subsequent cases suggest that the party seeking to invalidate a statute on grounds of vagueness bears a high burden.

C. Are the Payments Extraordinary?

The Intervenors contend that the Cash Payments have two components, "Unpaid Accrued Items" and a "termination fee." The Court addresses each of these components in turn.

1. Unpaid Accrued Items

As to the Unpaid Accrued Items, the Intervenors assert that this amount really comprises three parts: 1) accrued unused vacation pay; 2) accrued unpaid salary; and 3) accrued unpaid bonuses, for 2001.

	Yuen	Leung
Vacation	$1,921,870	$474,406
Salary	$1,028,489	$191,231
Bonuses	$4,080,418	$544,058
TOTAL	$7,030,777	$1,209,695

These breakdowns are not reflected in the Termination Agreements themselves, but are the apportionments agreed upon by Gemstar and the Intervenors in the course of their negotiations.

Examining these Unpaid Accrued Items, the Court finds that two factors make this portion of the payments extraordinary. First, the circumstances under which the payments were made are extraordinary. The payments were negotiated over a five month period and involved the participation of the Gemstar Board, a Special Committee, and outside consultants. The Board, the Special Committee, and the Intervenors were each represented by separate sets of counsel. Additionally, the Termination Agreements were executed as part of the process of removing both Leung and Yuen from their positions as Gemstar officers. After the restructing was effected, Gemstar saw fit to report the

terms of the agreements as an "Item 5" in a Form 8-K filing.[8] In short, the manner in which the Termination Agreements were negotiated and the changes that they effected indicate that the Termination Agreements and the payments negotiated within them are anything but ordinary.

Second, the payments are large in amount. Yuen would receive nearly $3 million for accrued vacation and salary pay while Leung would receive over $600,000. The $4,080,418 and $544,058 allegedly attributable to bonuses payable to Yuen and Leung, respectively, also appear to be extraordinarily large.[9]

Notwithstanding the unusual circumstances and the size of the payments, Intervenors nevertheless contend that the amounts attributable to Unpaid Accrued Items are not extraordinary. Initially, they argue that the unused vacation pay, accrued unpaid salary, and accrued unpaid bonuses all derive from prior legal obligations, and thus cannot be extraordinary. The Court finds the Intervenors' argument that prior legal obligations are automatically[10]

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[8] Item 5 provides, in pertinent part:

> The registrant may, at its option, report under this Item any events, with respect to which information is not otherwise called for by this form, that the registrant *deems of importance to security holders.*

Form 8-K, item 5 (emphasis added).

[9] As well, to the extent that the bonuses are keyed to Gemstar's financial performance—the accuracy of which is alleged to have been compromised by the Intervenors—the Court must view the payments with a skeptical eye.

[10] The Court is not suggesting that the pre-existing nature of an obligation should *never* be taken into account—only that it does not *automatically* exclude such payments from Section 1103. For example, the fact that a payment to an officer was a repayment for an earlier personal loan extended by the officer would be one factor that would influence a Section 1103 decision.

outside the scope of Section 1103 to be inconsistent with both the plain meaning and the purpose of the statute. *See supra.* Moreover, the Intervenors' reading of Section 1103 would create an exception that would consume the rule. If pre-existing legal obligations are by definition not extraordinary, corporate executives could simply negotiate payments ahead of time, and the Commission would be unable to stop such payments.

The Intervenors also contend that the existing nature of the obligations should be taken into account when evaluating whether the payments are extraordinarily large. They argue that if these payments are based on former obligations, then they are by definition no larger than what the Intervenors had been paid in past years.

One significant problem with this argument is that the Termination Agreements themselves do not make the apportionments and characterizations set forth by the Intervenors in these proceedings. The actual agreement states that the Cash Payments are for "full and complete settlement for all unpaid salary, bonuses and unused vacation days due under the Current Employment Agreement or otherwise." (Arkin Decl. Ex. A at 2 (Yuen.), Ex. B at 2 (Leung).) While Gemstar and the Intervenors ultimately came to an agreement as to the amounts attributable to unpaid salary, bonuses, and unused vacation days, Gemstar's position is that at the time the Termination Agreements were negotiated, everything about the underlying obligations, including which particular employment agreement governed, was in dispute. It is thus unclear as to how much, if any, of the amounts at issue were actually derived from prior legal obligations. In any event, other factors present in this case such as the manner in which the Termination Agreements were negotiated, and the circumstances surrounding the execution of those agreements, suggest that the Unpaid

Accrued Items would be extraordinary, regardless of whether it was partially derived from prior obligations.

The Intervenors also argue that accrued vacation pay cannot be an extraordinary payment because under applicable California law, the "right to vacation pay is nonforfeitable and such pay will be paid to the employee on the termination of his employment for any reason." *Evans v. Unemployment Ins. Appeals Bd.*, 39 Cal.3d 398, 414 (1985); *see also Suastez v. Plastic Dress-Up Co.*, 31 Cal.3d 774 (1982).

Even aside from the obvious supremacy clause problems raised by the position, *see U.S. Const.* art. VI, this reliance on *Evans* and *Saustez* is misplaced. *Evans* and *Saustez* deal with the issue of whether accrued vacation pay may be forfeited, not with whether the vacation pay may be withheld to offset some other liability. In *Saustez*, for example, the court held that an employee's vacation pay "vested" as it was earned, such that a subsequent event (e.g., not reaching an anniversary of employment) could not act to divest the employee of that accrued vacation pay. *Saustez*, 31 Cal.3d at 780-84. The *Evans* court held that accrued vacation paid after an employee ceases working cannot be offset against pension payments. *Evans*, 39 Cal.3d at 414-16. Both cases relied on the principle that once earned, vacation pay could not, either directly or indirectly, be unearned.

Application of Section 1103 would not contradict the principle set forth in *Saustez* and *Evans*. To begin with, Section 1103 results in a temporary deprivation, not a permanent deprivation, usually associated with a "forfeiture." More importantly, an injunction under Section 1103 would say nothing about whether the vacation pay had been accrued; it would only speak as to whether vacation pay, if accrued, could be used to satisfy a potential judgment. That is, even if Yuen and Leung are

adjudged to be legally entitled to their accrued vacation pay, nothing would prevent this Court from using those funds to satisfy a judgment. A contrary interpretation would necessarily lead to the absurd result that accrued vacation pay, whether in the hands of the employer or in the hands of the employee, is inviolable and can never be used to satisfy a judgment.

2. Termination Fee

The second portion of the Cash Payments is what the Termination Agreements label "termination fee." Again, neither Gemstar nor the Intervenors provide a satisfactory explanation as to the basis of that fee. In any event, other factors present in this case such as the manner in which the Termination Agreements were negotiated, and the circumstances surrounding the execution of those agreements indicate that the termination fees are exactly the type of payments that the drafters of Section 1103 sought to enjoin.

V. Conclusion

For the foregoing reasons, the Court finds that the Cash Payments at issue are extraordinary payments subject to Section 1103 and shall be placed in escrow for 45 days pursuant to that provision.

Dated: June 20, 2003

WM. MATTHEW BYRNE, JR.
Honorable Wm. Matthew Byrne, Jr.
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 03-56129

Argued and Submitted January 7, 2004
Filed May 12, 2004

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

HENRY C. YUEN; ELSIE M. LEUNG,

Intervenors-Appellants,

—v.—

GEMSTAR-TV GUIDE INTERNATIONAL, INC.,

Defendant.

Securities and Exchange Commission (SEC) sought to continue, for duration of pending fraud action against corporation's former officers, temporary escrow of termination payments made to officers by corporation. The United States District Court for the Central District of California, William Matthew Byrne, J., granted SEC's application, and officers sought interlocutory appeal.

The Court of Appeals, Bea, Circuit Judge, held that:

(1) Court of Appeals had jurisdiction over interlocutory appeal, and

(2) as a matter of first impression, District Court's determination that termination payments constituted "extraordinary payments" under Sarbanes-Oxley Act, warranting escrow, required initial determination of what would constitute "ordinary" payments in same or similar circumstances.

Vacated and remanded.

Trott, Circuit Judge, filed dissenting opinion.

Michelle A. Rice, Stanley S. Arkin, Arkin Kaplan LLP, New York, NY, for the intervenors-appellants.

Richard M. Humes, Thomas J. Karr, Securities and Exchange Commission, Washington, DC, for the applicant-appellee.

Sean T. Prosser, Kimberly S. Greer, Fish & Richardson P.C., San Diego, CA, for the defendant.

Appeal from the United States District Court for the Central District of California; Wm. Matthew Byrne, Jr., District Judge, Presiding. D.C. No. CV-03-03124-MRP.

Before: TROTT, RAWLINSON, and BEA, Circuit Judges.

BEA, Circuit Judge:

I

We decide a question of first impression: whether under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 15 U.S.C. § 78u-3 ("Section 1103"), certain termination payments to high-level corporate officials are "extraordinary payments," subject to involuntary retention in an escrow account compelled by court order. Because there was no evidence as to what would be an ordinary payment under comparable circumstances, we conclude that the district court erroneously determined certain payments proposed to be made by Defendant Gemstar-TV Guide International Inc. ("Gemstar") to Intervenors-Appellants Yuen and Leung (hereafter Appellants) were "extraordinary payments" within the meaning of section 1103 of Sarbanes-Oxley. We vacate the district court's order and remand for further proceedings consistent with this opinion.

In view of our ruling, we do not decide whether section 1103 of Sarbanes-Oxley is unconstitutionally vague, or operates in an unconstitutionally retroactive manner.

II
FACTS

On August 14, 2002, Gemstar, a Delaware corporation, announced that it was auditing the operations of its Technology and Licensing Sector and Interactive Plat-

form Sector after finding that 2001 revenues and related amortization for these sectors had been overstated by some $40 million. On November 7, 2002, Gemstar announced plans to restructure its management and corporate governance.

As part of the restructuring plans, Gemstar entered into negotiations for termination agreements with its Chief Executive Officer ("CEO"), Dr. Henry Yuen, and its Chief Operating Officer ("COO") and Chief Financial Officer ("CFO"), Elsie Ma Leung. Dr. Yuen's termination agreement provided for a "termination fee" of $22,452,640, an additional $7,030,778 in unpaid salary, bonuses, and unused vacation time, and 5,274,519 shares of restricted stock. Ms. Leung was to receive a termination fee of $6,957,953, an additional $1,209,695 in unpaid salary, bonuses, and unused vacation time, 1,126,504 shares of common stock, and 353,680 shares of restricted stock. Additionally, Yuen agreed to serve as the non-executive chairman of the board and Leung agreed to a position as an employee in the international business department. The arrangements for Yuen's and Leung's compensation are collectively referred to as the Restructuring Payments.

On October 15, 2002, before the Yuen and Leung termination agreements were in final form, attorneys for the Securities and Exchange Commission ("SEC") met with counsel for Gemstar, Yuen, and Leung, and requested that the Restructuring Payments be placed in escrow. On October 17, 2002, the SEC ordered a formal investigation into the announced overvaluation of the revenue and profits from some of Gemstar's sectors. On October 23, 2002, Yuen and Leung notified the SEC that they declined to submit to a voluntary escrow.

On October 28, 2002, as part of its investigation, the SEC issued testimonial subpoenas to Gemstar's Board of

Directors. Yuen and Leung contend that in response to the subpoenas Gemstar sent a draft escrow agreement for the Restructuring Payments to the SEC on November 6, 2002. Hours before the restructuring agreements were to be executed on November 7, 2002, Gemstar informed Yuen and Leung's attorney that the Restructuring Payments were to be placed in escrow for six months, and that such escrow provision was non-negotiable. Yuen and Leung acceded to the six-month escrow in "side letters" executed that day.

On March 31, 2003, Appellants Yuen and Leung filed a complaint in district court against the SEC, objecting to the escrow, seeking injunctive and declaratory relief, and requesting a temporary restraining order to unblock and dissolve the escrow to allow the restructuring payments to be made. According to a declaration by Appellants' counsel, "Gemstar is contractually obligated to release the Restructuring Payments to Plaintiffs on May 6, 2003." Appellants' counsel also maintained that the escrow impermissibly interfered with Yuen's and Leung's property rights to receive the Restructuring Payments, and that the escrowed payments did not constitute "extraordinary payments" under section 1103 of Sarbanes-Oxley. Following an April 21, 2003 hearing, the district court denied Appellants' request for a preliminary injunction, finding that the side letters constituted consent by Yuen and Leung to the initial escrow, set to expire May 6, 2003. The district court did not address whether the restructuring payments qualified as "extraordinary payments" under section 1103.

On May 5, 2003, the SEC filed an application with the district court to place the Restructuring Payments in a 45-day escrow account pursuant to Section 1103. In a declaration filed with the application, an attorney for the SEC described the ongoing investigation of Gemstar.

The district court *sua sponte* ordered the parties to maintain the status quo and requested additional briefing. A hearing was held on May 9, 2003. On May 12, 2003, the district court entered an order granting the SEC's application to place the Restructuring Payments in escrow and directed the parties to prepare a joint order to effect such escrow. Appellants filed a motion to reconsider the escrow order on May 22, 2003. After a status conference on May 29, 2003, the court denied Appellants' motion to reconsider and entered the joint order of escrow. The order specifically described the disputed funds as "extraordinary payments" subject to section 1103, and directed that they be held in interest-bearing accounts for 45 days.[1]

On June 19, 2003, the SEC commenced a civil action in the Central District of California, No. 03-CV-4376, alleging Yuen and Leung had fraudulently inflated Gemstar's revenue reports by $223 million, in violation of various sections of the Securities Acts of 1933 and 1934. The SEC also filed an application to have the escrow continued indefinitely for the duration of the action against Yuen and Leung.

On June 20, 2003, on the government's *ex parte* motion, the district court extended the temporary escrow for an additional 45 days. The district court reiterated its finding that the payments were "extraordinary payments" within the meaning of section 1103, and rejected Appellants' contentions that the statute was unconstitutionally vague. On June 24, 2003, the district court entered an order directing the maintenance of the escrow for the duration of the SEC's civil action.

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[1] The record does not indicate location of the escrow or the interest rate applied to the escrow accounts.

Yuen and Leung filed a notice of interlocutory appeal on July 2, 2003.[2] Appellants contend section 1103(1) is void for vagueness; (2) effects an unreasonable seizure of their property in violation of the Fourth Amendment; (3) does not retroactively apply to the payments in this case that had already been contracted to be paid or had already been made prior to the enactment of the statute; and (4) does not apply to the disputed payments, which are not "extraordinary payments" for the purposes of Sarbanes-Oxley.[3]

III
SECTION 1103

Section 1103 of the Sarbanes-Oxley Act gives the SEC authority to ensure that assets of an issuer of securities[4]

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[2] The notice of appeal specified that Yuen and Leung were appealing only the temporary orders of May 12, 2003, May 29, 2003, and June 20, 2003. The notice of appeal did not include the district court's currently operative order of June 24, 2003. We granted Yuen's and Leung's motion to amend their notice of appeal to include the June 24, 2003 order.

[3] At this time, only one other case involving an asset freeze under Sarbanes-Oxley had been published, *See SEC v. Healthsouth Corp.*, 261 F.Supp.2d 1298 (N.D.Ala.2003). *Healthsouth* does not specifically address what constitutes sufficient evidence of "extraordinary payments" under section 1103. The district court in *Healthsouth* construed the SEC's escrow request as an equitable motion for preliminary injunction and rejected the imposition of an escrow on the ground that the SEC could not show likely success on the merits. The court concluded that "no other basis for granting the relief requested by the SEC exists." *Healthsouth Corp.*, 261 F.Supp.2d at 1317.

[4] An issuer is defined as "any person who issues or proposes to issue any security . . ." 15 U.S.C. § 78c(a)(8). It is undisputed that Gemstar was, at all times relevant, an issuer of securities within the meaning of Sarbanes-Oxley.

which have been fraudulently obtained are not dissipated during the investigation and litigation of securities fraud cases. *See* 15 U.S.C. § 78u-3 (2002). Specifically, section 1103 provides that:

> [w]henever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

15 U.S.C. § 78u-3(c)(3)(A)(i). Such an order can be secured only with notice and after a hearing, unless "impracticable or contrary to the public interest." 15 U.S.C. § 78u-3(c)(3)(A)(ii).

Section 1103 authorizes one additional 45-day extension of the temporary escrow order on a showing of good cause. 15 U.S.C. § 78u-3(c)(3)(A)(iv). However, once the subject of an investigation is charged with a securities violation by the commencement of a civil action, "the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order." 15 U.S.C. § 78u-3(c)(3)(B)(i).

Sarbanes-Oxley does not define "extraordinary payments." The SEC is empowered to adopt regulations for the implementation of Sarbanes-Oxley. *See* 15 U.S.C. § 78w. To date the SEC has not done so. Neither

Congress nor the SEC has given any indication as to the meaning of the words "extraordinary payments."

IV
STANDARD OF REVIEW

The district court's escrow order is reviewed for abuse of discretion. *See United States v. Cal-Almond, Inc.*, 102 F.3d 999, 1001 (9th Cir.1996) (affirming denial of motion to impose escrow). The district court abuses its discretion when it applies incorrect legal standards or makes clearly erroneous findings of fact. *Id.* at 1003. The district court's interpretation and construction of a federal statute are questions of law reviewed *de novo*. *SEC v. McCarthy*, 322 F.3d 650, 654 (9th Cir.2003).

V
ANALYSIS

1. Jurisdiction

As a threshold issue, the SEC has argued that this appeal is moot because the orders specified in the notice of appeal are no longer in effect. Mootness is grounded in the Constitution's jurisdictional requirement that federal courts can hear only cases involving an actual case or controversy; mootness preempts any determination on the merits. *See Cammermeyer v. Perry*, 97 F.3d 1235, 1237 (9th Cir.1996). Mootness turns on "whether there exists a present controversy as to which effective relief can be granted." *Village of Gambell v. Babbitt*, 999 F.2d 403, 406 (9th Cir.1993) (citation and internal quotation marks omitted). As noted in footnote 2 above, because the court granted Appellants' motion to amend its notice of appeal to include the district court's order of June 24,

2003, which extended the escrow until the completion of the underlying litigation, the SEC's mootness challenge fails.

The parties are in agreement that this court has jurisdiction pursuant to 28 U.S.C. § 1292(a)(1). They characterize the escrow order entered by the district court as an appealable Rule 65 preliminary injunction rather than a non-appealable provisional remedy under Rule 64. *See* Fed.R.Civ.P. 64, 65. This issue is not free from doubt, for the escrow order was entered as an exercise of an explicit statutory provision, rather than grounded on any traditional equitable considerations such as are normally required for a preliminary injunction. *See, e.g., Southwest Voter Registration Educ. Project v. Shelley,* 344 F.3d 914, 917-18 (9th Cir.2003) (en banc). We are also mindful that jurisdiction of this court cannot be imposed simply by agreement of the parties. *See Owen Equip. & Erection Co. v. Kroger,* 437 U.S. 365, 377, n. 21, 98 S.Ct. 2396, 57 L.Ed.2d 274 (1978).

However, in the circumstances of this case, we find that the district court's order is analogous to a preliminary injunction and we have jurisdiction under section 1292(a). *See Cal-Almond, Inc.,* 102 F.3d at 1001 (exercising section 1292(a)(1) jurisdiction and affirming district court's order placing contested advertising and promotion assessments in escrow).

2. Statutory Construction

This appeal presents issues of statutory construction of the term "extraordinary payments." In its June 20, 2003 order, the district court correctly noted, " 'extraordinary' in common parlance essentially means 'out of the ordinary' or 'unusual.' Unusual, of course, is a *comparative adjective* that has meaning only in relation to what is 'usual.' " District Court's June 20, 2003 Mem-

randum of Decision at 9 (emphasis added).[5] This observation has value only if properly applied. Unfortunately, it was not.

"It would seem that, ordinarily, one could determine what was 'extraordinary' and 'abnormal,' or not normal, only by comparison with what was established to be normal." *Bjelland & Co., Inc. v. United States,* 45 Cust. Ct. 435, 442 (Cust.Ct., Jul. 26, 1960) (on appeal for reappraisement of imported goods, affirming customs appraiser's valuation of good exchanged in the "ordinary course of trade"). Here, plaintiff SEC limited its proof in its section 1103 application to an investigating attorney's affidavit (Cebeci Declaration, Excerpts of Record at 111-58). The affidavit incontestably established the first element of section 1103: that an SEC investigation was under way. 15 U.S.C. § 78u-3(c)(3)(B)(i).

However, the affidavit—and consequently the record—is completely silent regarding what constituted usual or ordinary payments upon termination of a CEO and Chairman of the Board (Yuen) or COO and CFO (Leung) under the same or similar circumstances to those existing at the time that Appellants ended their employment with Gemstar. Absent any such proof, the district court erroneously substituted two conclusory statements of what was "extraordinary" without concomitant proof of what was "ordinary," and an SEC filing, required under a standard different from that of section 1103.

First, the district court found that the negotiation of the termination agreements for Appellants was "extraordinary" because of the various groups that participated in the negotiations and because the negotiations occurred

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[5] The district court correctly resorted to "common parlance" in interpreting section 1103. *United States v. Migi,* 329 F.3d 1085, 1088 (9th Cir.2003).

over a five-month period. Members of the Board of Directors, officers of the corporation, and compensation consultants, accountants, and attorneys for both sides negotiated the restructuring agreements. Nothing in the record suggests this extended negotiation constitutes a deviation from the norm for corporate decision-making of this type. While common experience of the district court might help to determine what is the usual way to negotiate the termination of a lawyer at a law firm or a staff member of the court, common experiences of this kind do not aid judgment in the circumstances of Appellants' termination at Gemstar.

As the declaration of Appellants' counsel shows (Excerpts of Record at 15-23), Gemstar-TV Guide was the product of a merger between an off-shore company founded by Appellants and TV Guide, a subsidiary of News Corporation, a large telecommunications company. The corporation's earnings before interest, taxes, depreciation and amortization were reported as $242.2 million in the last nine months of 2000. Appellants presented uncontradicted evidence that revenue-producing strategies of Yuen and Leung differed, if not clashed, with those of News Corp. Appellants were interested primarily in raising revenue attributable to the corporation's sales, perhaps not coincidentally to raise their own compensation, which was tied to revenue and profits. The minority owners, Gemstar's current management, were in part interested in publicizing one of their sister corporations through Gemstar's operations, without paying Gemstar any advertising revenue. Such a strategy would increase revenues for the sister corporation, but not for Gemstar. As owners and officers in Gemstar, Appellants would not share in the profits of the sister corporation.

In case Yuen or Leung were terminated "without cause," lengthy and complex employment agreements governed their termination payments (Supplemental Excerpts of Record at 79, 118). Yuen and Leung had three different components for calculation of their Annual Incentive Bonuses. Complex enough when based on the company's past performance, computations also had to be done for future payments, with the consequent and predictable squabbling over methods for projecting future financial performance.

In view of Gemstar's revenue structure, the conflicting strategies, and the complex schemes for computation of termination payments, it is not surprising that Gemstar would require not only releases, but also representations and warranties from the departing employees. Yet, for all the persons involved in the negotiations, not one presented evidence before the district court that the period or mechanics of the negotiations were out of the ordinary in view of the circumstances. Nor, despite the six-month period between commencement of the investigation (October 17, 2002) and the section 1103 hearing (May 9, 2003), was any expert testimony prepared and presented as to the habits and customs of the marketplace—what was "ordinary"—under the same or similar circumstances.[6]

The second factor on which the district court based its finding that the proposed payments were "extraordinary payments" was their size. *See* Memorandum of Decision at 19. We agree that such sums are "extraordinary payments" in relation to what federal judges are paid. How-

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[6] This observation is not to be taken as a direction that, on remand, expert testimony is either required or admissible. As always, the choice of evidence is a matter for the parties. The admission of expert evidence is, in the first instance, a matter for the district court. *See* Fed.R.Evid. 702.

ever, nothing in section 1103 constrains us to look through such a prism.

There is no evidence in the record of what similarly placed officers and board members of corporations of similar revenues and worth are paid upon termination. Such payments may be called "golden parachutes" or "golden handshakes" in the press, but purple prose is not enough to prove a statutory requirement in court. For enforcement of the securities laws of the United States, **evidence** of what is "usual" under the same or similar circumstances is necessary to distinguish "extraordinary payments" and to order their impoundment in an escrow pursuant to section 1103.

Last, the district court found it significant that after the termination contracts were finalized, defendant Gemstar chose to report the terms in a Form 8-K filing. A Form 8-K filing is required from an "issuer of securities when substantial events occur . . ." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 528 n. 6, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). In this era of heightened corporate vigilance, it is not surprising that Gemstar management should choose to make this report upon the termination of the founders of the company, who were being paid millions of dollars on departure in an amount approximating 15% of the previous year's revenues. But, a discretionary corporate disclosure is not an admission that the company has paid an "extraordinary" amount. In any case, there was also no evidence of whether other "issuers" had made similar reports for similar sums paid to similarly departing upper management under the same or similar circumstances. A "substantial event" may or may not coincide with an "extraordinary payment." Only evidence of comparable events and circumstances can tell us.

Instead of objective evidence, what we have here is the district court's conjecture as to what would have been "ordinary" or "usual" negotiations for termination payments, conjecture as to what the size should have been of such payments and conclusions drawn from filings made under different standards. The bases used by the district court to judge the negotiations, the payments, and the filing were "irreducibly subjective." *cf. Nuñez v. San Diego,* 114 F.3d 935, 943 (9th Cir.1997) (considering vagueness challenge to loitering ordinance).

The district court did not need to rely on such subjective bases. Legislation which uses relative adjectives to proscribe activities is not unknown to the law. Statutes and law prohibit "excessive" verdicts (CAL. CIV. PROC. CODE § 657; Fed.R.Civ.P. 59) and sanction "unreasonable" behavior (CAL. CIV. CODE § 1714; Restatement (Second) of Torts, § 281). It is not beyond the judiciary's capacity to interpret and apply statutes which prohibit "excessive" or "unreasonable" amounts. Trial and appellate courts are called upon to do so every day.[7] As to

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[7] For instance, courts are often called upon to determine whether awards of attorney's fees are "reasonable." *See Pennsylvania v. Delaware Valley Citizens' Council for Clean Air,* 478 U.S. 546, 562, 106 S.Ct. 3088, 92 L.Ed.2d 439 (1986). "The fee applicant has the burden of producing satisfactory evidence, in addition to the affidavits of its counsel, that the requested rates are in line with those prevailing in the community for similar services of lawyers of reasonably comparable skill and reputation." *Jordan v. Multnomah County,* 815 F.2d 1258, 1263 (9th Cir.1987) (citation omitted). The proffered evidence of reasonable fees must constitute "more than a mere 'rough guess' or initial approximation of the final award to be made." *Pennsylvania,* 478 U.S. at 564, 106 S.Ct. 3088.

Likewise, courts daily determine what are "extraordinary" fees in probate courts across the country. But, unlike the district court, those probate courts have elaborate statutes, rules of procedure and case authority to guide them in determining what services by estate representatives are

"excessive," *see State Farm Ins. Co. v. Campbell,* 538 U.S. 408, 123 S.Ct. 1513, 1519-20, 155 L.Ed.2d 585 (2003). But in doing so, the courts are guided by precepts of proportionality and precedent.

Less often, courts are asked whether some remuneration constitutes "extraordinary payment." An example is the line of cases which determines whether payments made by a corporation to an employee is deductible from gross income as an "ordinary and necessary" business expense, or is an "extraordinary payment" disallowed as a deduction. *See, e.g., LabelGraphics, Inc. v. Commissioner of Internal Revenue,* 221 F.3d 1091, 1096 (9th Cir.2000); *Elliotts, Inc. v. Commissioner Internal Revenue,* 716 F.2d 1241, 1242 (9th Cir.1983).

Whether the adjective is "excessive," "negligent" or "extraordinary," the cases in which those terms appear use similar processes of judgment. The trier-of-fact determines first what constitutes "adequate compensation," "reasonable care," or "customary or ordinary payments." Such determinations require evidence which consists of similar factual situations which can be compared to the case at hand. If the case at hand falls outside the bounds permitted in the comparison cases, that result is deemed "excessive," "negligent," or "extraordinary."

Absent a definition from Congress, "we interpret the words using their 'ordinary, contemporary, and common meaning[s].' " *United States v. Migi,* 329 F.3d at 1088. As is suggested in the district court's order, the statute's qualifying term "extraordinary" necessarily implies proof that the payments deviate from the ordinary. *See*

"ordinary" (and covered by the statutory fees) and what expenses are "extraordinary," conferring entitlement to added fees. *See e.g.* CAL. PROB. CODE §§ 10801, 10811; CAL. COURT R. 7.702; *In re Fulcher's Estate,* 234 Cal.App.2d 710, 718, 44 Cal.Rptr. 861 (1965).

Chalmers v. City of Los Angeles, 796 F.2d 1205, 1215 (9th Cir.1985) (holding that counsel's success was not extraordinary in light of the evidence presented at trial and the non-complexity of the case). A reasonable interpretation of the common meaning of section 1103 requires that the questioned payments be out of the ordinary. Not mere government assertion, but proof by admissible objective evidence of what is ordinary is necessary to allow a court to determine what is extraordinary. Such evidence was not adduced in the district court; that absence requires the reversal of the judgment of the district court.

VI
CONCLUSION

For the reasons stated, Appellants' appeal from the June 24, 2003 escrow order is granted, and that order is vacated and remanded for proceedings consistent with this opinion.

The clerk is directed to stay the mandate in this case for 14 calendar days following the filing of this opinion, should the government seek to file a renewed section 1103 request consistent with the standard of proof outlined in this opinion.

VACATED AND REMANDED; the Clerk shall stay the mandate for 14 days after the filing of this opinion.

TROTT, Circuit Judge, dissenting:

The principal issue we decide in this case arises in a distinctive statutory context that cannot be ignored or slighted. Judge Wallace cogently explained this impor-

tant context in *SEC v. Rind,* 991 F.2d 1486 (9th Cir.1993):

> When the [Securities and Exchange] Commission sues to enforce the securities laws, it vindicates public rights and furthers the public interest. The public character of Commission action is reflected in the introduction to the 1934 Act: "[T]ransactions in securities . . . are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions." 15 U.S.C. § 78b. Congress entrusted the Commission with the vital mission of ensuring the honesty and fairness of the capital markets. "The entire purpose and thrust of a [Commission] enforcement action is to expeditiously safeguard the public interest by enjoining securities violations. The claims asserted in such an action stem from, and are colored by, the intense public interest in [Commission] enforcement of these laws." *SEC v. Asset Management Corp.,* 456 F.Supp. 998, 1000 (S.D.Ind.1978).

Id. at 1491. In reversing the district court's decision in this case, I respectfully believe my colleagues have unintentionally overlooked this context, a context which makes the securities business one of the most highly regulated in our nation. In so doing, their opinion deals an unwarranted blow to the public interest and to the Commission's ability adequately to protect that broad interest against the flood of corporate scandals of which Congress and the public has become all too painfully aware in the past few years. Thus, I dissent.

I

The civil statute under our microscope, Section 1103, 15 U.S.C. § 78u-3(c)(3) is extraordinarily narrow, well defined, and utterly clear. It comes into play only

> (1) during the course of a lawful investigation by the Securities and Exchange Commission,
>
> (2) involving possible violations of the federal securities law,
>
> (3) committed by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees,
>
> (4) whenever it shall appear to the Commission that it is likely that the issuer will make extraordinary payments to any of those named persons.

See 15 U.S.C. § 78u-3(c)(3). In other words, this law covers only insiders making shadowy payments to insiders.

Should this combination of events occur, then Congress has empowered the Commission to petition a federal district court for nothing more onerous than a temporary order requiring the issuer under scrutiny to escrow those intended payments to insiders for no more than 45 days in a very familiar device, an interest bearing account—all of this subject to court supervision.

This protocol on its face bears all the hallmarks and indicia of due process of law and protections for the rights and interests of all concerned in securities matters, including the public and investors. It is a civil law that imposes no penalties, it does not implicate any constitutionally-protected behavior, and it regulates only issuers of publicly-traded securities. Its purpose is to protect corporate funds and the investing public against

theft, fraud, and dissipation. As the Commission underscores in its brief, (1) the initial escrow lasts for only 45 days with the possibility of a 45-day extension, *see* 15 U.S.C. § 78u-3(c)(3)(A)(I); (2) any person affected by the escrow order has the right to petition the court for relief, *see* 15 U.S.C. § 78u-3(c)(3)(B)(i); and (3) if no enforcement action is filed before the temporary escrow expires, the "extraordinary payments involved" shall be returned to the issuer or other affected person with accrued interest, *see* 15 U.S.C. § 78u-3(c)(3)(A)(I), (B)(ii). The issue brought to us, of course, arises from Congress' use of the word "extraordinary," and the basic claim is that this word is so vague that it renders this entire process unlawful. I respectfully believe this claim has no merit.

II

Faced with one giant corporate scandal after another, Congress' purpose in enacting this mild, temporary measure could not be clearer. One after another, stockholders and others have been left holding an empty bag after corporate insiders engaged in fraud and other corporate crimes at the ultimate expense of the corporation's shareholders and innocent employees. By the time the authorities have been alerted to the fraud, it's too late, the money has already disappeared into the pockets of those who abused their fiduciary responsibilities and the public trust, rendering the traditional remedies used by the Commission to rectify such wrongs—disgorgement, civil penalties, restitution, etc.—difficult if not impossible to pursue. In the meanwhile, the disappearance of such funds impoverishes and damages the issuer itself, once again to the detriment of the shareholders and innocent employees, whose pensions in many cases have

been permanently thrashed. Ultimately, our nation is the victim, as the public loses confidence in the stock market.

Section 1103 was initially introduced as Amendment No. 4188, by Senator Trent Lott. *See* 148 Cong. Rec. S6542 (daily ed. July 10, 2002). In the debate that ensued after Amendment No. 4188's introduction, different senators focused on various possible abuses that Section 1103 was meant to prevent:

> Section 3 freezes payments of potential wrongdoers. This section would allow the SEC, during an investigation, to seek an order in Federal court imposing a 45-day freeze on extraordinary payments to corporate executives. Again, this year we have seen just that sort of thing happening. While an investigation is underway, basically rewards were given to those corporate executives. While it would require a court order, there would be this 45-day freeze. The targeted payments would be placed in escrow, ensuring that corporate assets are not improperly taken from [sic] an executive's personal benefit.... We have also seen that there are some cases where the law had some loopholes or where it was not timely or where it was not strong enough. One example, of course, is where there has been shredding. Another example is the very bad image of corporate executives taking increased payments, extraordinary payments, while they are being investigated. You can't have that sort of thing.

Id. (statement of Sen. Lott).

The House of Representatives shared these objectives:

> Under this legislation, top executives will not be allowed to pilfer the assets of the company by giving themselves huge bonuses and other extraordi-

> nary payments if the company is subject to an [sic] SEC investigation. Their pay and benefits are frozen when the investigation starts. Americans will know that corporate officers will no longer be able to misuse the bankruptcy laws to discharge liabilities based upon securities fraud, and the honest brokers of corporate America will know that those who abuse the law and tarnish corporate America's reputation will go to jail for a long, long time.

148 Cong. Rec. H4685 (daily ed. July 16, 2002) (statement of Rep. Sensenbrenner).

III

The facts and circumstances of this case provide a textbook example of the problem. On April 1, 2002, Gemstar filed its Form 10-K for the year 2001. The filing reported that $107.6 million it had previously claimed as revenue had not actually been realized. Gemstar revealed also that it had previously claimed as substantial revenue receipts from a single "nonmonetary transaction" that was not properly booked. The fall-out from these reevaluations? The next day, Gemstar's stock price declined by a startling 37 percent. But, this was just the beginning. A Form 8-K is a Commission report used to report "material events or corporate changes" that may have an effect on the value of a company's securities. On August 14, 2002, Gemstar announced in a Form 8-K that it intended to restate its 2001 financial results and to reverse $20 million, plus make substantial corrections. Gemstar filed as exhibits to that Form 8-K sworn statements from Yuen and Leung, CEO and CFO respectively, to the effect that they were not able to certify as required by law that some of Gemstar's financial

statements were accurate, and that they were not able to comply with Commission orders to do so.

On September 25, 2002, Gemstar filed yet another Form 8-K (1) confirming that it had been notified by NASDAQ that its securities were subject to delisting for failure timely to file a Form 10-Q for the quarter ending on June 30, 2002, (2) that because of an unresolved dispute between Gemstar and its independent auditor KPMG, the company could not file its quarterly Form 10-Q report, and (3) that the resolution of these accounting and financial matters involving restatement of financial statements was "uncertain" and "unpredictable." Clearly, the accounting wheels were falling off this company.

What about Intervenors CEO Yuen and CFO Leung, *whose compensation was tied to the performance of Gemstar's reported financial results?* On March 27, 2002, all of four days before the revelation to the public about Gemstar's inaccurate revenue claims, Yuen disposed of 7 million Gemstar shares, receiving an initial payment of $59 million. No doubt the purchasers of these shares were duped into believing they were getting fair value for their money, only to see the roof fall in when the facts came publicly to light.

Back at the ranch, and simultaneously with the internal and external unraveling of this creative accounting mess, CEO Yuen and CFO Leung were cutting a new deal with Gemstar's Board to resign from their respective executive positions—but remain as employees—in return for a payment in cash by Gemstar to Yuen of $29.48 million and to Leung of $8.16 million, plus enormous shares of stocks and stock options. Gemstar reported these unusual developments on November 12, 2002, in yet another Form 8-K filing. It is this package of payments around which Yuen and Leung fashion their

unconvincing and extraordinary claim that the negotiated payments were not "extraordinary," and that the term "extraordinary" is vague.

Not surprisingly, the Commission finally commenced a formal investigation of this odorific scenario to determine whether Gemstar and its former and present officers and directors had engaged in securities fraud by making materially false and misleading public statements regarding revenue, earnings and losses, etc., for the relevant years.

IV

Here, it is important and instructive to understand what must happen in order for the Commission to launch an investigation into suspected violations of the securities laws, an action which is a prerequisite to petitioning the court under Section 1103 for a temporary escrow.

Both the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") provide the Commission the authority to initiate investigations into suspected violations of the securities laws. *See* 15 U.S.C. § 77t(a) ("Whenever it shall appear to the Commission . . . that the provisions of this subchapter . . . have been or *are about to be violated*, it may . . . investigate such facts." (emphasis added)); 15 U.S.C. § 78u(a)(1) ("The Commission may . . . make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter . . . ").

A formal investigation is the process by which the SEC issues subpoenas calling for document production or testimony, supported by the power of the federal courts. To enable the staff of the SEC, rather than the

individual, appointed members of the SEC, to perform such an investigation, the Commission must delegate its powers to the staff in a Formal Order of Investigation. That Formal Order of Investigation consists of three parts: 1) a jurisdictional section setting forth the SEC's investigative authority; 2) a probable cause section setting forth the information which, "if true, tends to show" that certain activities have occurred and securities laws have been violated; and 3) a delegation section, containing a statement by the Commission that it is delegating its investigative power to the staff. *See* Marvin Pickholz, SEC Crimes, § 2:4 (Dec.2003); *see also* Am.Jur. Securities, § 1622 (noting that in most circumstances "[n]either a Commission decision whether to conduct a preliminary investigation nor a formal order of investigation is a final order which may be judicially reviewed").

Here, the Formal Order of Investigation, which was part of the Commission's submission to the district court pursuant to Section 1103, was signed on October 17, 2002. In relevant part, it says:

II

> Members of the staff have reported information to the Commission which tends to show that from at least 1999 to the present:
>
> A. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities, directly or indirectly, in the offer or sale of, or in connection with the purchase or sale of Gemstar securities, may have employed a device, scheme, or artifice to defraud, made or obtained money or property by means of an untrue statement

of material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or engaged in transactions, acts, practices or courses of business which operated or would operate as a fraud or deceit upon any person. As part of the aforesaid activities, such persons or entities may have, directly or indirectly, among other things, made materially false and misleading statements and may have traded in Gemstar stock while in possession of material nonpublic information in breach of a fiduciary or other duty arising out of a relationship of trust and confidence concerning, among other things, Gemstar's revenues and earnings or losses as set forth in Gemstar's 1999, 2000, 2001 and 2002 Forms 10-K and 10-Q;

B. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities failed or caused the failure to file or filed or caused to be filed with the Commission annual reports on Form 10-K and quarterly reports on Form 10-Q which may have contained an untrue statement of material fact or may have omitted to state a material fact necessary, or may have failed to add such further material information as may be necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading concerning, among other things, Gemstar's revenue and earnings or losses.

C. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have failed to or caused the failure to:

1. make and keep books, records and accounts which, in reasonable detail, accurately and fairly

reflected Gemstar's transactions and disposition of assets;

2. devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with Generally Accepted Accounting Principles or any other criteria applicable to such statements, and to maintain accountability for assets;

D. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have, directly or indirectly, falsified or caused to be falsified, books, records, or accounts required to be maintained by Gemstar.

E. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have knowingly circumvented or knowingly failed to implement a system of internal accounting controls or knowingly falsified any book, record or account required to be maintained by Gemstar.

F. While engaged in the above described activities, such person or entities, directly or indirectly, made use of the mails or the means, instruments, or instrumentalities of transportation or communication in interstate commerce.

III

The Commission, having considered the staff's report and deeming such acts and practices, if true, to be in possible violation of Section 17(a) of the

> Securities Act of 1933 ("Securities Act") and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder, finds it necessary and appropriate and hereby:
>
> ORDERS, pursuant to Section 20(a) of the Securities Act and Section 21(a) of the Exchange Act, that a private investigation be made to determine whether any persons or entities have engaged in, or are about to engage in, any of the reported acts or practices or any acts or practices of similar purport or object;
>
> . . . .

The next step in this process is for the Commission to file with the district court an application for a temporary order pursuant to Section 1103. The Commission took this step on May 5, 2003, accompanied by a declaration in support executed by the Commission's attorney authorized to conduct the relevant investigation. Here are excerpts from the declaration, excerpts that sound very much like the allegations of probable cause to be found in a standard search warrant.

> 8. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has taken investigative testimony from 57 witnesses, for 105 days of testimony. The testimony has been taken throughout the United States.
>
> 9. The Commission's staff has scheduled the investigative testimony of additional witnesses.
>
> 10. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has issued regulatory requests to brokerage firms for brokerage account information.

11. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has issued over one hundred subpoenas for the production of documents. Pursuant to the subpoenas for the production of documents, the staff has received substantial document productions in response to the subpoenas.

12. On January 7, 1998, Henry Yuen entered into an Amended and Restated Employment Agreement ("Yuen's Employment Agreement") with Gemstar International Group, Ltd. and Gemstar Development Corp. (collectively with Gemstar-TV Guide International, Inc., "Gemstar"), a copy of which is attached hereto as Exhibit 2.

13. Under Yuen's Employment Agreement, Yuen's initial base salary was $1 million, subject to annual increases that were based on Gemstar's reported financial results. *See* Exhibit 2 at § 3(a).

14. Yuen's Employment Agreement contained a formula under which Yuen's base salary could increase each year, depending upon annual percentage increases in Gemstar's consolidated revenues and consolidated net earnings, as reported in Gemstar's financial statements. *Id.*

15. Yuen's Employment Agreement contained a provision for an annual merit bonus that was calculated using Gemstar's reported financial results. The formula used his adjusted base salary and the annual percentage increase, if any, in Gemstar's consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA"). Yuen could elect to receive his merit bonus in the form of cash or stock options. *Id.* at § 3(b).

16. Yuen's Employment Agreement also included a provision for an annual incentive bonus that was calculated using Gemstar's reported financial results. The formula used his adjusted base salary and increases in Gemstar's consolidated earnings per share as reported in Gemstar's Forms 10-Q and 10-K. Yuen could elect to receive his annual incentive bonus in the form of cash or stock options. *Id.* at § 3(c) & Schedule I.

17. Yuen's Employment Agreement provided Yuen with annual stock options. *Id.* at § 3(d).

18. During the investigation, the staff took Yuen's testimony on April 1, 2003, when he answered general background questions. The staff did not inquire into specific transactions in any detail. Yuen appeared again to provide testimony on April 23, 2003, at which time Yuen asserted his Fifth Amendment privilege against self-incrimination in response to all questions.

19. I have examined Forms W-2 issued to Yuen by Gemstar from 1999 through 2002, and have added the amounts of compensation reported on the Forms W-2 for those four years, which totals $37,849,002.35. The staff understands that this includes salary and wages, as well as monies related to the exercise of stock options.

20. The staff has analyzed brokerage records from Yuen's brokerage firm, including a "Master Agreement" dated March 27, 2002, and confirmations of transactions executed under that agreement. The brokerage records show that between April 3, 2002 and April 8, 2002, Yuen entered into "prepaid forward" transactions to dispose of 7 million shares of

Gemstar stock. The brokerage records show that Yuen received an initial payment from the disposition of these 7 million shares of approximately $59 million.

21. A copy of Gemstar's press release, dated October 8, 2001, entitled *Gemstar-TV Guide International, Inc. CEO and CFO Exercise Options to Acquire and Hold Shares,* is attached hereto as Exhibit 3.

22. *On March 31, 1998, Elsie Leung entered into an Amended and Restated Employment Agreement with Gemstar International Group, Ltd. and Gemstar Development Corp. ("Leung's Employment Agreement"), a copy of which is attached hereto as Exhibit 4.*

23. Under Leung's Employment Agreement, her initial base salary was $700,000, subject to annual increases based on Gemstar's financial results. *Id.* at § 3(a).

24. Leung's Employment Agreement included a formula to calculate annual increases in her base salary, which used annual percentage increases in Gemstar's consolidated revenues and consolidated net earnings as shown in Gemstar's financial statements. *Id.*

25. Leung's Employment Agreement included a provision for an annual incentive bonus based upon Gemstar's financial results. The formula for calculating Leung's incentive bonus used her adjusted base salary and increases in Gemstar's consolidated earnings per share as reported in Gemstar's Forms 10-Q and 10-K. *Id.* at § 3(b) & Schedule I.

26. Leung's Employment Agreement further provided Leung with annual stock options. *Id.* at § 3(c).

27. I have examined Forms W-2 issued to Leung by Gemstar from 1999 through 2002, and have added the amounts of compensation reported on the Forms W-2 for those four years, which totals $11,180,561.28.

28. A copy of Gemstar's press release dated October 8, 2002 entitled *Gemstar Approves Management Changes; Jeff Shell to Become CEO,* is attached hereto as Exhibit 5.

29. A copy of Gemstar's press release dated April 18, 2003 entitled *Gemstar-TV Guide Terminates Employment of Yuen and Leung,* is attached hereto as Exhibit 6.

30. A copy of Gemstar's press release dated March 7, 2001, entitled *Gemstar-TV Guide International, Inc. Reports Financial Results For the Quarter and Fiscal Year Ended December 31, 2000,* is attached hereto as Exhibit 7.

31. A copy of Gemstar's press release dated November 14, 2001 entitled *Gemstar-TV Guide International, Inc. Reports Financial Results For the Quarter Ended September 30, 2001,* is attached hereto as Exhibit 8.

32. A copy of Gemstar's press release dated March 18, 2002 entitled *Gemstar-TV Guide International, Inc. Reports Financial Results For the Quarter and Year Ended December 31, 2001,* is attached hereto as Exhibit 9.

33. A copy of the relevant pages of Gemstar's Form 10-K, filed April 1, 2002, is attached hereto as Exhibit 10.

34. A copy of Gemstar's press release dated August 14, 2000, entitled *Gemstar-TV Guide International, Inc. Reports Financial Results of Gemstar International Group Limited For the Quarter Ended June 30, 2000,* is attached hereto as Exhibit 11.

35. A copy of Gemstar's Form 8-K, filed August 14, 2002, is attached hereto as Exhibit 12.

36. A copy of the relevant pages from Gemstar's Form 10-K/A, for the fiscal year ended December 31, 2001, and filed on March 31, 2003, is attached hereto as Exhibit 13.

37. A copy of Gemstar's press release dated January 23, 2003 entitled *Gemstar-TV Guide International Announces Further Anticipated Restatements Related to Previously Disclosed Review,* is attached hereto as Exhibit 14.

38. A copy of Gemstar's press release dated March 10, 2003 entitled *Gemstar-TV Guide International Announces Further Anticipated Restatements Related to Previously Disclosed Review,* is attached hereto as Exhibit 15.

39. On May 2, 2003, the staff provided notice to counsel for Gemstar, pursuant to Local Rule 7-19.1, that the Commission had authorized the staff to file an Application under Section 1103 of Sarbanes-Oxley Act of 2002 to seek a temporary order requiring Gemstar to escrow any extraordinary payments to its employees. The staff informed counsel for Gemstar that the Commission intended to file the Application on May 5, 2003, as early in the morning as possible.

(Emphasis added).

In a supplemental memorandum in support of its application for a temporary order, the Commission made its compelling case that the payments at issue were not regular payments in the everyday operation or normal management of Gemstar. In many instances, the Commission simply pointed out what Yuen and Leung would have been normally entitled to, and then highlighted the differences arising from the suspect Termination Agreements that were not usual and ordinary, and thus "extraordinary." I highlight and quote from the memorandum:

I. *INTRODUCTION*

> The Securities and Exchange Commission ("Commission") seeks a temporary order preventing Gemstar-TV Guide International, Inc., (Gemstar") [sic] from making any extraordinary payments to certain persons for a period of 45 days, under Section 1103 of the Sarbanes-Oxley Act of 2002. Respondent Gemstar does not oppose entry of an order maintaining the status quo. Intervenors Henry C. Yuen and Elsie Leung (collectively "Intervenors") oppose such an order because they contend:
>
> (1) they should be heard before any order is entered;
>
> (2) there is no reason to enter the order on an expedited basis; (3) the payments are not extraordinary under Section 1103; and (4) Section 1103 is unconstitutional.

II. *ARGUMENT*

A. *The Restructuring Payments are Extraordinary Payments under Section 1103*

> The principal issue is whether the Restructuring Payments of $37.64 million in cash are extraordi-

nary payments under Section 1103. Yuen and Leung admit that the *payments are being made pursuant to their November 7, 2002 "Termination Agreements" with Gemstar that were the subject of at least five months of extended negotiation and approval by Gemstar's entire Board of Directors.* (Yuen Memo at p. 9.) Yuen and Leung also admit that the Restructuring Payments were made to effect their removal as Chief Executive Officer and Chief Financial Officer, respectively, and to remove control of Gemstar's Board of Directors from Yuen. *The Restructuring Payments and their circumstances are so extraordinary that Yuen asserted his Fifth Amendment privilege to all questions about his compensation during testimony on April 25, 2003.* Under these circumstances, the Restructuring Payments are extraordinary payments.

Yuen and Leung ignore the significant events that are the basis for the Restructuring Payments, and focus only on the components which they characterize as ordinary payments made under "long standing contractual commitments." (*Id.* p. 8.) However, the operative agreements under which the Restructuring Payments are being made are the November 7, 2002 Termination Agreements, entered into on the same day that the payments originally were to be disbursed by Gemstar. *The Restructuring Payments are being made pursuant to the Termination Agreements, which by their terms supersede all other agreements between the parties. The restructuring was so significant that Gemstar issued a press release announcing it on October 8, 2002, and filed a Form 8-K on November 7, 2002.*

Yuen and Leung also ignore that, *in terms of relationship to annual compensation,* the Restructuring Payments are extraordinary. Yuen is to receive a total of $56.7 million in cash and stock, of which $29.48 million is cash. *This is more than five times Yuen's 2001 base salary of approximately $5 million a year.* Leung is to receive $14.4 million in cash and stock, of which $8.16 million is cash. *Similarly, this is more than six times Leung's 2001 base salary of $1.3 million.*

There can be little dispute that the Restructuring Payments are not being made in a normal and usual course of business, but rather are "for an exceptional purpose or a special occasion." Black's Law Dictionary, at p. 406 (Abridged Sixth Edition 1991). Indeed, if there were nothing remarkable about these payments, then Yuen could have testified freely about them on April 25, 2003; instead, he invoked his Fifth Amendment privilege against self-incrimination with respect to all questions about his compensation.

B. *The Component Amounts Are Extraordinary Payments Under Section 1103*

Yuen and Leung misdirect the Court away from the events and circumstances of the Restructuring Payments and the total $37.64 million in cash, and focus instead on alleged components of the Restructuring Payments, which they identify as: (1) termination fees or severance payments; (2) accrued unpaid bonuses for 2001; (3) accrued unpaid salary; and (4) accrued unused vacation pay.

However, the Termination Agreements do not describe the Restructuring Payments as having the

same components Yuen and Leung now advance to the Court: Yuen's Termination Agreement describes the payments as: "(I) a termination fee of $22,452,640 and (ii) $7,030,778 (in *full and complete settlement* for all unpaid salary, bonuses and unused vacation days due under the Current Employment Agreement *or otherwise*)." Leung's is similar. The Termination Agreements state that the single lump sum payments are a "settlement" of amounts due or "otherwise," and not merely simple contractual payments due in the ordinary course. The description in the Termination Agreements is consistent with Intervenors' admission that the Restructuring Payments were the subject of "extended" negotiations, and that *component amounts that make up the lump sum settlement payments in the Termination Agreements are largely different than amounts due under their employment agreements.*

Yuen's and Leung's argument that the Court should look at each component in isolation, and not in context of the events and the governing documents, should be rejected. Under their argument, an extraordinary payment would escape Section 1103 if made up of components that can be characterized as usual or ordinary. Thus, if the Court finds that the "vacation pay" component is not extraordinary, then in the future an issuer and its employees will simply call suspect extraordinary payments "vacation pay" to evade the statute. Section 1103 should not be read in a restrictive manner that would render it meaningless, but rather it should be read broadly to effect the remedial purposes of the federal securities laws. *See, e.g., SEC v. Zandford,* 535 U.S. 813, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002).

1. *The termination fees are extraordinary payments*

Yuen and Leung admit that the bulk of the funds are a termination fee or severance payment, but do not provide any specific arguments why these are not extraordinary payments under Section 1103. *Yuen and Leung admit that the amount of termination fees were negotiated, and are substantially different than the severance payments they may have been entitled to under their existing employment agreements.* The Termination Agreements provide that Yuen is to receive a "termination fee" of $22.45 million, and Leung a "termination fee" of $6,957,953.

The "termination fees" are the amounts agreed to, after extended negotiation between Gemstar, Yuen, and Leung, as the amounts Gemstar must pay to terminate Yuen and Leung. *Generally, the termination of a chief executive officer or chief financial officer is an extraordinary event, usually accompanied by a public announcement and a Form 8-K filing, as it was here.*

2. *The accrued unpaid bonuses for 2001*

Bonuses are clearly the type of extraordinary payments encompassed by Section 1103. By definition, a bonus is not an ordinary and usual payment, but rather a "consideration or premium paid in addition to what is strictly due" and a "premium or extra or irregular remuneration." As Senator Lott commented about Section 1103: "While an investigation is underway, basically rewards were given to these corporate executives." *Any common sense interpretation of a bonus understands that it is a special reward for meeting or surpassing goals.*

Yuen and Leung's 2001 bonuses are exactly the type of payments that should be frozen: their bonuses are rewards for Gemstar's 2001 reported financial results. The Commission is investigating whether Gemstar's 2001 financial results were fraudulently overstated. Since Yuen and Leung (and others) signed and filed Gemstar's 2001 Form 10-K on April 1, 2002, Gemstar has restated and reversed substantial revenue items contained in the 2001 Form 10-K. *The very set of events Section 1103 was designed to prevent is implicated by the bonus payments: while the Commission is attempting to determine whether Gemstar's 2001 financial results were overstated and fraudulent, Yuen and Leung are demanding to be paid for those results.*

Under their employment agreements, the calculation of Yuen and Leung's bonuses is tied directly to Gemstar's reported financial results. Yuen's "merit bonus" is calculated using his adjusted base salary and Gemstar's percentage increase in EBITDA (earnings before interest, taxes, depreciation, and amortization). Yuen and Leung each had an identical provision in their employment agreements for an "incentive bonus," calculated based on Gemstar's reported financial results.

3. *The accrued unpaid salary*

The unpaid salary component of the settlement amount is, like the bonus payment component, directly dependent upon Gemstar's reported 2001 financial statements that are under investigation by the Commission. *Yuen and Leung's employment agreements included a formula for the annual adjustment of their base salary. Under that formula,*

if consolidated revenues or consolidated net earnings increase, then Yuen and Leung's base salary is increased by a proportional amount. (*Id.*, Ex 2, at 18 (Yuen Employment Agreement, ¶ 3(a)); Ex. 4, at 55 (Leung Employment Agreement ¶ 3(a)).

The calculation of the "catch-up" salary based upon allegedly fraudulent financial statements is, again, exactly the type of "reward" about which Section 1103 is concerned. Gemstar has restated hundreds of millions of dollars of revenues from multiple transactions since Yuen and Leung entered into the Termination Agreements. *To the extent Gemstar's reported financial results have been overstated for a number of years (as indicated by the restatements), Yuen and Leung's compensation and bonuses are terminally infected with those overstatements.*

4. *The accrued unused vacation pay*

The extraordinary nature of the vacation pay amount in the settlement is revealed by the context. In the ordinary course, an employee would take their vacation time during a year and receive their salary while on vacation. The employee is paid accrued but unused vacation pay only on a special occasion—when their employment is terminated. [Sic] *But for the restructuring and their removal, Yuen and Leung had no contractual rights, under their employment agreements, to be paid for accrued but unused vacation.*

(Emphasis Added).

V

Given the context of Section 1103 and the narrowly defined, regulated, and targeted area to which it applies, I conclude that Congress' use of the term "extraordinary" in connection to payments being made by the issuer to those insiders possibly under investigation for potential securities fraud does not constitute a legal or a constitutional infirmity in this statute. "Extraordinary" simply means, in plain language, out of the ordinary. In this context—and the *context* is the key—"out of the ordinary" simply means a payment made not in the customary or normal pursuit of the regular trade or business of the issuer *under scrutiny,* but in response to an irregular or abnormal demand of the moment that reasonably appears to have been provoked or motivated by or connected to the possible violations of securities laws that triggered the investigation.

There is no need necessarily to engage in metaphysical inquiries about what is ordinary in another company or to look to some sort of an industry standard to ascertain the meaning of this provision. One can simply look *at the business* of the issuer and determine whether the payments under scrutiny directly advance the issuer's normal business objectives, or whether the payment reasonably appears to be in the nature of damage control, hush money, taking financial advantage of the fraud, cover-up, looting, etc.

The district court had it exactly right. The court looked *in context* at (1) the circumstances of the payment, (2) the purpose of the payment, and (3) the size of the payment. The court concluded in a thorough, thoughtful, and well-reasoned, 23-page decision that the Commission "has met its burden" "under almost any standard."

The court correctly focused on the nature, purpose, and circumstances of the payments and determined that they had *nothing* to do with Gemstar's ordinary business. The court accurately noted that

> [t]he payments were negotiated over a five-month period and involved the participation of the Gemstar Board, a Special Committee, and outside consultants. The Board, the Special Committee, and the Intervenors Yuen and Leung were each represented by separate sets of counsel. Additionally, the termination agreements were executed as part of the process of removing Leung and Yuen from their positions as Gemstar Officers.

The court concluded that the termination agreements and the disputed payments "are anything but ordinary." I agree. Why? Because the measure of "extraordinary" is what ordinarily goes on in the process of the issuer's business, and these facts are clearly unusual and extraordinary. As the Commission's supplemental memorandum points out, the negotiated Termination Agreement payments here are five and six times greater than Yuen's and Leung's base salary, the component amounts that make up the lump sum payments are different than the amounts due under their employment agreements, the termination fees are different from what they may have been entitled to under existing agreements, the bonuses are fruit of the alleged fraudulent financial results, and the vacation pay item did not exist under their contracts. One would not expect benefits like these to be flowing from corporate assets to executives resigning under fire. This scenario is not business as usual. It appears to be looting. I believe, as did the district court, that Gemstar's execution of *its* overall business objectives and ordinary management of *its* business operations did not

entail terminating its CEO and CFO in the shadow of misstated revenues, misleading public statements, securities fraud investigations, plunging stock prices, and public relations debacles, not to mention Yuen's and Leung's inability to certify Gemstar's books as accurate. If these mega-suspicious payments were not "extraordinary," the word needs either to be redefined or to be taken out of our dictionaries. Gemstar's Form 8-K filings raise red flags all over the place.

Do we really expect the government to offer evidence of what constitutes "usual or ordinary payments to a CEO and a CFO under same or similar circumstances," i.e., under threat of delisting, in a fight with its independent auditor, and under investigation for having misstated revenues, cooked the books, defrauded investors, employees and the market, and possibly committed a basket full of crimes? Why would this be necessary? On reflection, the idea that a court needs somehow to have evidence of a "norm for corporate decision-making *of this type,*" i.e., rampaging fraud and a world of trouble, seems off the mark. In some cases, one might need to look to a norm, but not this one. Legal "probable cause" statements do not need information about how normal people act to create a reasonable suspicion with respect to the targeted suspects. These insiders appear, from the record submitted to the district court, to be pirates engaged in cookie jar mismanagement of Gemstar. The Commission subsequently sued them for multiple securities fraud violations, seeking anti-fraud injunctions, civil money penalties, and disgorgement of ill-gotten gains, including salaries, bonuses, and proceeds from the sale of stock—each one of which is at the epicenter of the payments at issue. The Commission's complaint alleges that because their compensation was linked to Gemstar's reported financial results, Yuen and Leung

reaped millions of dollars in financial gains—in excess salary, bonuses, and options—from their fraudulent manipulations of Gemstar's revenues, to the tune of an overstatement of those revenues by at least $223 million.

Congress designed Section 1103 to add teeth to the Commission's ability to perform its mission. It ensures that recovery by way of disgorgement, etc., is effective rather than empty. As for the importance of disgorgement, we have said,

> Disgorgement plays a central role in the enforcement of the securities laws. The effective enforcement of the federal securities laws requires that the Commission be able to make violations unprofitable. The deterrent effect of a Commission enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits. By deterring violations of the securities laws, disgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets. Although the Commission at times may use the disgorged proceeds to compensate injured victims, this does not detract from the public nature of Commission enforcement actions: the touchstone remains the fact that public policies are served and the public interest is advanced by the litigation.

Rind, 991 F.2d at 1491-92 (citations, internal quotation marks, and alterations omitted).

Finally, the proof of the extraordinary nature of this pudding is in the eating. The multimillion-dollar, suspicious-resignation Termination Agreements, which Yuen and Leung claim are not extraordinary, were approved and signed by Jonathan Orlick, Gemstar's General Counsel, now also a defendant in a civil fraud com-

plaint filed by the SEC, involving fraud allegedly arising out of this same tarnished episode in Gemstar's existence. So much for the ordinary course of business argument.

Yuen and Leung bring other issues to our attention, such as whether Section 1103 is void for vagueness, whether it violates the Fourth Amendment, whether its application here is impermissibly retroactive, etc. These issues also have no merit.

Thus, and with all respect to my colleagues, I dissent.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 03-56129
Argued and Submitted December 15, 2004
Filed March 22, 2005

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

HENRY C. YUEN; ELSIE M. LEUNG,
Intervenors-Appellants,

—v.—

GEMSTAR-TV GUIDE INTERNATIONAL, INC.,
Defendant.

Michelle Rice, Arkin Kaplan LLP, for Yuen & Leung, New York, NY, for the intervenors-appellants.

Richard M. Humes, Securities and Exchange Commission, Washington, D.C., for the plaintiff-appellee.

Thomas J. Karr, Securities and Exchange Commission, Washington, D.C., for the plaintiff-appellee.

Richard L. Stone, for Gemstar-TV Guide, for the defendant-respondent-appellee.

Sean T. Prosser and Kimberly S. Greer, Morrison & Foerster LLP, San Diego, CA, for the defendant-respondent-appellee.

Appeal from the United States District Court for the Central District of California; Wm. Matthew Byrne, Jr., District Judge, Presiding. D.C. No. CV-03-03124-WMB/MRP.

Before: SCHROEDER, Chief Judge, REINHARDT, TROTT, THOMAS, GRABER, MCKEOWN, WARDLAW, FISHER, CLIFTON, CALLAHAN, and BEA, Circuit Judges.

Opinion by Judge TROTT; Concurrence by Judge REINHARDT; Dissent by Judge BEA.

TROTT, Circuit Judge:

In response to a formal application by the Securities and Exchange Commission ("SEC" and "Commission"), the district court entered an order pursuant to Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 78u-3(c)(3), placing in escrow in excess of $37 million representing contemplated one-time payments by Gemstar-TV Guide International, Inc. ("Gemstar"), a public corporation, to its resigning Chief Executive Officer ("CEO"), Dr. Henry Yuen, and its Chief Financial Officer ("CFO"), Elsie Leung. This escrow order—directed

to Gemstar—was predicated upon the district court's conclusion under the statute that these payments, which were to be made during the course of a lawful investigation by the SEC of Gemstar involving possible violations of federal securities laws, were "extraordinary." Gemstar did not oppose the entry of this order and has not filed a substantive brief in connection with this appeal. However, Intervenors-Appellants Yuen and Leung do appeal, claiming (1) that this statute is unconstitutionally vague on its face and as applied to them; (2) that the district court erred as a matter of law in its interpretation of the statutory term "extraordinary payments"; and (3) that the district court erred in its determination that the payments in question could be deemed "extraordinary."[1] Title 28 U.S.C. § 1292(a)(1) gives us jurisdiction over this timely appeal, and we affirm.

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[1] Appellants claim also that this statute violates the Fourth Amendment's prohibition against unreasonable searches and seizures. This assertion has no merit. As will be apparent from our discussion of the remaining issues, the formal administrative and judicial process established by Congress whereby assets might be "seized" in this industry pursuant to court order easily satisfies the Supreme Court's three-part test articulated in *New York v. Burger*, 482 U.S. 691, 702-03, 107 S.Ct. 2636, 96 L.Ed.2d 601 (1987), which established an exception from the warrant requirement under certain delineated circumstances involving "closely regulated" businesses. First, the government's interest on behalf of the public that drives this process is certainly "substantial." Second, the process resulting, without a search, in a temporary "seizure" is patently necessary to further the regulatory scheme; and third, by involving the district courts as the decision-maker, the program as legislated is plainly "a constitutionally adequate substitute for a warrant." In sum, this process is "reasonable" as required by the Fourth Amendment. *See also United States v. V-1 Oil Co.*, 63 F.3d 909 (9th Cir.1995) (applying the Burger test to regulated businesses transporting hazardous materials).

I

The civil statute under our microscope, Section 1103, 15 U.S.C. § 78u-3(c)(3), is narrow, well defined, and clear. It comes into play only

> (1) during the course of a lawful investigation by the SEC,
>
> (2) involving possible violations of the federal securities laws,
>
> (3) committed by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees,
>
> (4) whenever it shall appear to the Commission that it is likely that the issuer will make extraordinary payments to any of those named persons.

See 15 U.S.C. § 78u-3(c)(3)(A)(I). Should this combination of events occur, as happened here, Congress has empowered the Commission to petition a federal district court for nothing more onerous than a temporary order requiring the issuer under scrutiny to escrow those intended payments to a clearly defined group of insiders for no more than 45 days in a very familiar device, an interest-bearing account—all of this subject to court supervision.

This protocol on its face bears the hallmarks and indicia of due process of law and protection for the rights and interests of all concerned, including the public, the shareholders who own the corporation, and third-party creditors who hold corporate debt—as well as the persons to whom such payments might be made. It is a civil law that imposes no penalties, does not implicate any constitutionally protected behavior, and regulates only issuers of publicly traded securities. Enacted in the dis-

turbing shadow of a flood of corporate scandals, its purpose is to temporarily protect corporate funds and the investing public and creditors against theft, fraud, and dissipation. As the Commission underscores in its brief, (1) the initial escrow lasts for only 45 days with the possibility of a single 45-day extension, *see* 15 U.S.C. § 78u- 3(c)(3)(A)(I), (iv); (2) any person affected by the escrow order has the right to petition the court for relief, *see* 15 U.S.C. § 78u-3(c)(3)(B)(I); and (3) if no enforcement action is filed before the temporary escrow expires, the "extraordinary payments" involved shall be returned to the issuer or other affected person with accrued interest, *see* 15 U.S.C. § 78u-3(c)(3)(B)(ii).

The issues brought to us arise primarily from Congress' use of the word "extraordinary." The intervenor-appellants claim that the district court erred in its interpretation and application of the word "extraordinary" and that the word is so vague that it renders this entire process unlawful. Upon examination, these claims are unpersuasive.

II

Faced with one cataclysmic corporate accounting scandal after another, including Enron, WorldCom, and Tyco, Congress' purpose in enacting Section 1103's escrow measure could not be clearer. One after another, many persons, companies, and pension plans have been left holding an empty bag after corporate insiders committed fraud and other corporate crimes and misdeeds at the ultimate expense of the corporation's shareholders, creditors, and innocent employees. By the time the authorities have been alerted to the fraud, it's too late; the assets of the company have already disappeared, rendering the traditional remedies used by the Commission

to rectify such wrongs— disgorgement, civil penalties, restitution, etc.—difficult, if not impossible, to pursue. In the meanwhile, the disappearance of such funds impoverishes and damages the issuer itself, once again to the detriment of the shareholders, creditors, and innocent employees, whose pensions in many cases have been permanently thrashed. Ultimately, our nation is the victim, as the public loses confidence in the stock market.

Section 1103 was initially introduced as Amendment No. 4188 by Senator Trent Lott. *See* 148 Cong. Rec. S6542 (daily ed. July 10, 2002). In the debate that ensued after Amendment No. 4188's introduction, different senators focused on various possible abuses that Section 1103 was meant to prevent:

> Section 3 freezes payments of potential wrongdoers. This section would allow the SEC, during an investigation, to seek an order in Federal court imposing a 45-day freeze on extraordinary payments to corporate executives. Again, this year we have seen just that sort of thing happening. While an investigation is underway, basically rewards were given to these corporate executives. While it would require a court order, there would be this 45-day freeze. The targeted payments would be placed in escrow, ensuring that corporate assets are not improperly taken from [sic] an executive's personal benefit. . . . We have also seen that there are some cases where the law had some loopholes or where it was not timely or where it was not strong enough. One example, of course, is where there has been shredding. *Another example is the very bad image of corporate executives taking increased payments, extraordinary payments, while they are being investigated.* You can't have that sort of thing.

Id. at 56545 (statement of Sen. Lott) (emphasis added). The House of Representatives shared these objectives:

> Under this legislation, top executives will not be allowed to pilfer the assets of the company by giving themselves huge bonuses and other extraordinary payments if the company is subject to an SEC investigation. Their pay and benefits are frozen when the investigation starts. Americans will know that corporate officers will no longer be able to misuse the bankruptcy laws to discharge liabilities based upon securities fraud, and the honest brokers of corporate America will know that those who abuse the law and tarnish corporate America's reputation will go to jail for a long, long time.

148 Cong. Rec. H4685 (daily ed. July 16, 2002) (statement of Rep. Sensenbrenner). From this background, it is readily apparent that the intent of Congress in enacting this statute was to provide a strong shield for third-party creditors and corporate investors once the SEC begins an investigation of corporate malfeasance.

III

The facts and circumstances of this case provide a textbook example of the problem. On April 1, 2002, Gemstar filed its Form 10-K report for the year 2001. The filing reported that $107.6 million Gemstar had previously claimed as revenue had not actually been realized. Gemstar revealed also that it had claimed as substantial revenue receipts from a single "non-monetary transaction" that was not properly booked. The fallout from these reevaluations? The next day, Gemstar's stock price declined by a startling 37 percent. But, this was just the beginning. On August 14, 2002, Gemstar

announced in a Form 8-K—a Commission report used to report "material events or corporate changes" that may have an effect on the value of a company's securities, *see* 15 U.S.C. § 78m(a)(1); 17 C.F.R. § 240.13a-11—that it intended to restate its 2001 financial results and to reverse $20 million, plus make substantial corrections. Gemstar filed as exhibits to that Form 8-K sworn statements from CEO Yuen and CFO Leung, to the effect that they were not able to certify as required by law that some of Gemstar's financial statements were accurate, and that they were not able to comply with written Commission orders to do so.

On September 25, 2002, Gemstar filed yet another Form 8-K (1) confirming that it had been notified by NASDAQ that its securities were subject to delisting for failure timely to file a Form 10-Q for the quarter ending on June 30, 2002; (2) that because of an unresolved dispute between Gemstar and its independent auditor KPMG, the company could not file its quarterly Form 10-Q report; and (3) that the resolution of these accounting and financial matters involving restatement of financial statements was "uncertain" and "unpredictable." Clearly, the wheels were falling off this company.

What about Intervenors CEO Yuen and CFO Leung, whose compensation was tied to the performance of Gemstar's now-suspect reported financial results? On March 27, 2002, all of four days before the revelation to the public about Gemstar's inaccurate revenue claims, Yuen disposed of 7 million Gemstar shares, receiving an initial payment of $59 million. No doubt the purchasers of these shares believed they were getting fair value for their money, only to see the roof fall in when the facts became public.

Simultaneous with the internal and external unraveling of this creative accounting mess, CEO Yuen and

CFO Leung were cutting a new deal with Gemstar's Board to "resign" from their respective executive positions—but remain as employees—in return for a payment in cash by Gemstar to Yuen of $29.48 million and to Leung of $8.16 million, plus large shares of stock and stock options. Yuen would receive approximately 5.27 million shares of restricted stock or stock units, and Leung would receive options to purchase in excess of 1.1 million shares of common stock and 353,680 shares of restricted stock or stock options. Gemstar reported these unusual developments on November 12, 2002, in yet another Form 8-K filing. Not surprisingly, the Commission commenced a formal investigation of this scenario to determine whether Gemstar and its former and present officers and directors had engaged in actionable securities fraud by making materially false and misleading public statements regarding revenue, earnings and losses, etc., for the relevant years. It is this package of "restructuring payments" around which Yuen and Leung fashion their unconvincing claims that the term "extraordinary" is vague, and, in any event, that the negotiated payments were not "extraordinary."

IV

It is instructive to understand what must happen in order for the Commission to launch an investigation into suspected violations of the securities laws as a prerequisite to petitioning the court under Section 1103 for a temporary escrow.

Both the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") give the Commission the authority to initiate investigations into suspected violations of the securities laws. *See* 15 U.S.C. § 77t(a) ("Whenever it shall appear to the

Commission . . . that the provisions of this title . . . have been or *are about to be violated,* it may . . . investigate such facts." (emphasis added)); 15 U.S.C. § 78u(a)(1) ("The Commission may . . . make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this title. . . ."). A formal investigation is the process by which the SEC issues subpoenas calling for document production or testimony, supported by the power of the federal courts. To enable the staff of the SEC, rather than the appointed members of the SEC, to perform such an investigation, the Commission must delegate its powers to the staff in a Formal Order of Investigation. That order consists of three parts: (1) a jurisdictional section setting forth the SEC's investigative authority; (2) a probable cause section setting forth the information which, "if true, tends to show" that certain activities have occurred and securities laws have been violated; and (3) a delegation section, containing a statement by the Commission that it is delegating its investigative power to the staff. Marvin Pickholz, SEC Crimes, § 2:4 (Dec.2003); *see also* Am.Jur. Securities, Regulation-Federal § 1622 (noting that in most circumstances "[n]either a Commission decision whether to conduct a preliminary investigation nor a formal order of investigation is a final order which may be judicially reviewed").

Here, the Formal Order of Investigation, which was part of the Commission's submission to the district court pursuant to Section 1103, was signed on October 17, 2002. In relevant part, it says:

> Members of the staff have reported information to the Commission which tends to show that from at least 1999 to the present:

A. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities, directly or indirectly, in the offer or sale of, or in connection with the purchase or sale of Gemstar securities, may have employed a device, scheme, or artifice to defraud, made or obtained money or property by means of an untrue statement of material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or engaged in transactions, acts, practices or courses of business which operated or would operate as a fraud or deceit upon any person. As part of the aforesaid activities, such persons or entities may have, directly or indirectly, among other things, made materially false and misleading statements and may have traded in Gemstar stock while in possession of material nonpublic information in breach of a fiduciary or other duty arising out of a relationship of trust and confidence concerning, among other things, Gemstar's revenues and earnings or losses as set forth in Gemstar's 1999, 2000, 2001 and 2002 Forms 10-K and 10-Q;

B. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities failed or caused the failure to file or filed or caused to be filed with the Commission annual reports on Form 10-K and quarterly reports on Form 10-Q which may have contained an untrue statement of material fact or may have omitted to state a material fact necessary, or may have failed to add such further material information as may be necessary in order to make the statements made, in light of the circumstances under which they were made, not

misleading concerning, among other things, Gemstar's revenue and earnings or losses.

C. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have failed to or caused the failure to:

1. make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflected Gemstar's transactions and disposition of assets;

2. devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with Generally Accepted Accounting Principles or any other criteria applicable to such statements, and to maintain accountability for assets;

D. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have, directly or indirectly, falsified or caused to be falsified, books, records, or accounts required to be maintained by Gemstar.

E. Gemstar and its former and present officers, directors, employees, affiliates, and other persons or entities may have knowingly circumvented or knowingly failed to implement a system of internal accounting controls or knowingly falsified any book, record or account required to be maintained by Gemstar.

F. While engaged in the above described activities, such person or entities, directly or indirectly, made use of the mails or the means, instruments, or instru-

mentalities of transportation or communication in interstate commerce.

The Commission, having considered the staff's report and deeming such acts and practices, if true, to be in possible violation of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder, finds it necessary and appropriate and hereby:

ORDERS, pursuant to Section 20(a) of the Securities Act and Section 21(a) of the Exchange Act, that a private investigation be made to determine whether any persons or entities have engaged in, or are about to engage in, any of the reported acts or practices or any acts or practices of similar purport or object;

. . . .

The next step in this process is for the Commission to file with the district court an application for a temporary freeze order pursuant to Section 1103. The Commission took this step on May 5, 2003, accompanied by a supporting declaration executed by the Commission's attorney authorized to conduct the relevant investigation. Here are excerpts from the declaration, excerpts that sound much like the allegations of probable cause to be found in a standard search warrant:

8. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has taken investigative testimony from 57 witnesses, for 105 days of testimony. The testimony has been taken throughout the United States.

9. The Commission's staff has scheduled the investigative testimony of additional witnesses.

10. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has issued regulatory requests to brokerage firms for brokerage account information.

11. Since the Commission issued its Formal Order on October 17, 2002, the Commission's staff has issued over one hundred subpoenas for the production of documents. Pursuant to the subpoenas for the production of documents, the staff has received substantial document productions in response to the subpoenas.

12. On January 7, 1998, Henry Yuen entered into an Amended and Restated Employment Agreement ("Yuen's Employment Agreement") with Gemstar International Group, Ltd. and Gemstar Development Corp. (collectively with Gemstar-TV Guide International, Inc., "Gemstar"), a copy of which is attached hereto as Exhibit 2.

13. Under Yuen's Employment Agreement, Yuen's initial base salary was $1 million, subject to annual increases that were based on Gemstar's reported financial results. *See* Exhibit 2 at § 3(a).

14. Yuen's Employment Agreement contained a formula under which Yuen's base salary could increase each year, depending upon annual percentage increases in Gemstar's consolidated revenues and consolidated net earnings, as reported in Gemstar's financial statements. *Id.*

15. Yuen's Employment Agreement contained a provision for an annual merit bonus that was calculated using Gemstar's reported financial results. The formula used his adjusted base salary and the annual percentage increase, if any, in Gemstar's consoli-

dated earnings before interest, taxes, depreciation and amortization ("EBITDA"). Yuen could elect to receive his merit bonus in the form of cash or stock options. *Id.* at § 3(b).

16. Yuen's Employment Agreement also included a provision for an annual incentive bonus that was calculated using Gemstar's reported financial results. The formula used his adjusted base salary and increases in Gemstar's consolidated earnings per share as reported in Gemstar's Forms 10-Q and 10-K. Yuen could elect to receive his annual incentive bonus in the form of cash or stock options. *Id.* at § 3(c) & Schedule I.

17. Yuen's Employment Agreement provided Yuen with annual stock options. *Id.* at § 3(d).

18. During the investigation, the staff took Yuen's testimony on April 1, 2003, when he answered general background questions. The staff did not inquire into specific transactions in any detail. Yuen appeared again to provide testimony on April 23, 2003, at which time Yuen asserted his Fifth Amendment privilege against self-incrimination in response to all questions.

19. I have examined Forms W-2 issued to Yuen by Gemstar from 1999 through 2002, and have added the amounts of compensation reported on the Forms W-2 for those four years, which totals $37,849,002.35. The staff understands that this includes salary and wages, as well as monies related to the exercise of stock options.

20. The staff has analyzed brokerage records from Yuen's brokerage firm, including a "Master Agreement" dated March 27, 2002, and confirmations of

transactions executed under that agreement. The brokerage records show that between April 3, 2002 and April 8, 2002, Yuen entered into "prepaid forward" transactions to dispose of 7 million shares of Gemstar stock. The brokerage records show that Yuen received an initial payment from the disposition of these 7 million shares of approximately $59 million.

21. A copy of Gemstar's press release, dated October 8, 2001, entitled *Gemstar-TV Guide International, Inc. CEO and CFO Exercise Options to Acquire and Hold Shares,* is attached hereto as Exhibit 3.

22. *On March 31, 1998, Elsie Leung entered into an Amended and Restated Employment Agreement with Gemstar International Group, Ltd. and Gemstar Development Corp. ("Leung's Employment Agreement"), a copy of which is attached hereto as Exhibit 4.*

23. Under Leung's Employment Agreement, her initial base salary was $700,000, subject to annual increases based on Gemstar's financial results. *Id.* at § 3(a).

24. Leung's Employment Agreement included a formula to calculate annual increases in her base salary, which used annual percentage increases in Gemstar's consolidated revenues and consolidated net earnings as shown in Gemstar's financial statements. *Id.*

25. Leung's Employment Agreement included a provision for an annual incentive bonus based upon Gemstar's financial results. The formula for calculating Leung's incentive bonus used her adjusted

> base salary and increases in Gemstar's consolidated earnings per share as reported in Gemstar's Forms 10-Q and 10-K. *Id.* at § 3(b) & Schedule I.
>
> 26. Leung's Employment Agreement further provided Leung with annual stock options. *Id.* at § 3(c).
>
> 27. I have examined Forms W-2 issued to Leung by Gemstar from 1999 through 2002, and have added the amounts of compensation reported on the Forms W-2 for those four years, which totals $11,180,561.28.
>
> * * *
>
> 39. On May 2, 2003, the staff provided notice to counsel for Gemstar, pursuant to Local Rule 7-19.1, that the Commission had authorized the staff to file an Application under Section 1103 of Sarbanes-Oxley Act of 2002 to seek a temporary order requiring Gemstar to escrow any extraordinary payments to its employees. The staff informed counsel for Gemstar that the Commission intended to file the Application on May 5, 2003, as early in the morning as possible.

(emphasis added). As attachments to this application, the Commission included numerous press releases issued by Gemstar and excerpts from its 8-K and 10-K reports highlighting the tumult inside the company surrounding management changes and the restatement of financial results.

In a supplemental memorandum in support of its application for a temporary order, the Commission made a compelling case that the payments at issue were not regular payments in the everyday operation or normal management of Gemstar. In many instances, the Com-

mission simply pointed out what Yuen and Leung normally would have been entitled to, and then highlighted the differences arising from the Termination Agreements, notable differences that were not usual and not ordinary, and thus "extraordinary." We highlight and quote from the memorandum:

> I. *INTRODUCTION*
>
> The Securities and Exchange Commission ("Commission") seeks a temporary order preventing Gemstar-TV Guide International, Inc., ("Gemstar") [sic] from making any extraordinary payments to certain persons for a period of 45 days, under Section 1103 of the Sarbanes-Oxley Act of 2002. Respondent Gemstar does not oppose entry of an order maintaining the status quo. Intervenors Henry C. Yuen and Elsie Leung (collectively "Intervenors") oppose such an order because they contend: (1) they should be heard before any order is entered; (2) there is no reason to enter the order on an expedited basis; (3) the payments are not extraordinary under Section 1103; and (4) Section 1103 is unconstitutional.
>
> II. *ARGUMENT*
>
> A. *The Restructuring Payments are Extraordinary Payments under Section 1103*
>
> The principal issue is whether the Restructuring Payments of $37.64 million in cash are extraordinary payments under Section 1103. Yuen and Leung admit that the *payments are being made pursuant to their November 7, 2002 "Termination Agreements" with Gemstar that were the subject of at least five months of extended negotiation and approval by Gemstar's entire Board of Directors.* (Yuen Memo

at p. 9.) Yuen and Leung also admit that the Restructuring Payments were made to effect their removal as Chief Executive Officer and Chief Financial Officer, respectively, and to remove control of Gemstar's Board of Directors from Yuen. *The Restructuring Payments and their circumstances are so extraordinary that Yuen asserted his Fifth Amendment privilege to all questions about his compensation during testimony on April 25, 2003.* Under these circumstances, the Restructuring Payments are extraordinary payments.

Yuen and Leung ignore the significant events that are the basis for the Restructuring Payments, and focus only on the components which they characterize as ordinary payments made under "long standing contractual commitments." (*Id.* p. 8.) However, the operative agreements under which the Restructuring Payments are being made are the November 7, 2002 Termination Agreements, entered into on the same day that the payments originally were to be disbursed by Gemstar. *The Restructuring Payments are being made pursuant to the Termination Agreements, which by their terms supersede all other agreements between the parties. The restructuring was so significant that Gemstar issued a press release announcing it on October 8, 2002, and filed a Form 8-K on November 7, 2002.*

Yuen and Leung also ignore that, *in terms of relationship to annual compensation,* the Restructuring Payments are extraordinary. Yuen is to receive a total of $56.7 million in cash and stock, of which $29.48 million is cash. *This is more than five times Yuen's 2001 base salary of approximately $5 million a year.* Leung is to receive $14.4 million in cash and

stock, of which $8.16 million is cash. *Similarly, this is more than six times Leung's 2001 base salary of $1.3 million.*

There can be little dispute that the Restructuring Payments are not being made in a normal and usual course of business, but rather are "for an exceptional purpose or a special occasion." Black's Law Dictionary, at p. 406 (Abridged Sixth Edition 1991). Indeed, if there were nothing remarkable about these payments, then Yuen could have testified freely about them on April 25, 2003; instead, *he invoked his Fifth Amendment privilege against self-incrimination with respect to all questions about his compensation.*

B. *The Component Amounts Are Extraordinary Payments Under Section 1103*

Yuen and Leung misdirect the Court away from the events and circumstances of the Restructuring Payments and the total $37.64 million in cash, and focus instead on alleged components of the Restructuring Payments, which they identify as: (1) termination fees or severance payments; (2) accrued unpaid bonuses for 2001; (3) accrued unpaid salary; and (4) accrued unused vacation pay.

However, the Termination Agreements do not describe the Restructuring Payments as having the same components Yuen and Leung now advance to the Court: Yuen's Termination Agreement describes the payments as: "(I) a termination fee of $22,452,640 and (ii) $7,030,778 (in *full and complete settlement* for all unpaid salary, bonuses and unused vacation days due under the Current Employment Agreement *or otherwise*)." Leung's is similar. The Termination

Agreements state that the single lump sum payments are a "settlement" of amounts due or "otherwise," and not merely simple contractual payments due in the ordinary course. The description in the Termination Agreements is consistent with Intervenors' admission that the Restructuring Payments were the subject of "extended" negotiations, and that *component amounts that make up the lump sum settlement payments in the Termination Agreements are largely different than amounts due under their employment agreements.*

Yuen's and Leung's argument that the Court should look at each component in isolation, and not in context of the events and the governing documents, should be rejected. Under their argument, an extraordinary payment would escape Section 1103 if made up of components that can be characterized as usual or ordinary. Thus, if the Court finds that the "vacation pay" component is not extraordinary, then in the future an issuer and its employees will simply call suspect extraordinary payments "vacation pay" to evade the statute. Section 1103 should not be read in a restrictive manner that would render it meaningless, but rather it should be read broadly to effect the remedial purposes of the federal securities laws. *See, e.g., SEC v. Zandford,* 535 U.S. 813, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002).

1. *The termination fees are extraordinary payments*

Yuen and Leung admit that the bulk of the funds are a termination fee or severance payment, but do not provide any specific arguments why these are not extraordinary payments under Section 1103. *Yuen and Leung admit that the amount of termination fees were negotiated, and are substantially different than*

the severance payments they may have been entitled to under their existing employment agreements. The Termination Agreements provide that Yuen is to receive a "termination fee" of $22.45 million, and Leung a "termination fee" of $6,957,953.

The "termination fees" are the amounts agreed to, after extended negotiation between Gemstar, Yuen, and Leung, as the amounts Gemstar must pay to terminate Yuen and Leung. *Generally, the termination of a chief executive officer or chief financial officer is an extraordinary event, usually accompanied by a public announcement and a Form 8-K filing, as it was here.*

2. *The accrued unpaid bonuses for 2001*

Bonuses are clearly the type of extraordinary payments encompassed by Section 1103. By definition, a bonus is not an ordinary and usual payment, but rather a "consideration or premium paid in addition to what is strictly due" and a "premium or extra or irregular remuneration." As Senator Lott commented about Section 1103: "While an investigation is underway, basically rewards were given to these corporate executives." *Any common sense interpretation of a bonus understands that it is a special reward for meeting or surpassing goals.*

Yuen and Leung's 2001 bonuses are exactly the type of payments that should be frozen: their bonuses are rewards for Gemstar's 2001 reported financial results. The Commission is investigating whether Gemstar's 2001 financial results were fraudulently overstated. Since Yuen and Leung (and others) signed and filed Gemstar's 2001 Form 10-K on April 1, 2002, Gemstar has restated and reversed

substantial revenue items contained in the 2001 Form 10-K. *The very set of events Section 1103 was designed to prevent is implicated by the bonus payments: while the Commission is attempting to determine whether Gemstar's 2001 financial results were overstated and fraudulent, Yuen and Leung are demanding to be paid for those results.*

Under their employment agreements, the calculation of Yuen and Leung's bonuses is tied directly to Gemstar's reported financial results. Yuen's "merit bonus" is calculated using his adjusted base salary and Gemstar's percentage increase in EBITDA (earnings before interest, taxes, depreciation, and amortization). Yuen and Leung each had an identical provision in their employment agreements for an "incentive bonus," calculated based on Gemstar's reported financial results.

3. *The accrued unpaid salary*

The unpaid salary component of the settlement amount is, like the bonus payment component, directly dependent upon Gemstar's reported 2001 financial statements that are under investigation by the Commission. *Yuen and Leung's employment agreements included a formula for the annual adjustment of their base salary. Under that formula, if consolidated revenues or consolidated net earnings increase, then Yuen and Leung's base salary is increased by a proportional amount.* (*Id.*, Ex. 2, at 18 (Yuen Employment Agreement, ¶ 3(a)); Ex. 4, at 55 (Leung Employment Agreement ¶ 3(a))).

The calculation of the "catch-up" salary based upon allegedly fraudulent financial statements is, again, exactly the type of "reward" about which

Section 1103 is concerned. Gemstar has restated hundreds of millions of dollars of revenues from multiple transactions since Yuen and Leung entered into the Termination Agreements. *To the extent Gemstar's reported financial results have been overstated for a number of years (as indicated by the restatements), Yuen and Leung's compensation and bonuses are terminally infected with those overstatements.*

4. *The accrued unused vacation pay*

The extraordinary nature of the vacation pay amount in the settlement is revealed by the context. In the ordinary course, an employee would take their vacation time during a year and receive their salary while on vacation. The employee is paid accrued but unused vacation pay only on a special occasion—when their employment is terminated. [Sic] *But for the restructuring and their removal, Yuen and Leung had no contractual rights, under their employment agreements, to be paid for accrued but unused vacation.*

(emphasis added).

V

The district court's escrow order is reviewed for abuse of discretion. *See United States v. Cal-Almond, Inc.*, 102 F.3d 999, 1002-03 (9th Cir.1996) (analogizing escrow order to preliminary injunction and applying abuse of discretion standard). The district court abuses its discretion when it applies incorrect legal standards or makes clearly erroneous findings of fact. *Id.* at 1003. The district court's interpretation and construction of a

federal statute are questions of law reviewed de novo. *SEC v. McCarthy*, 322 F.3d 650, 654 (9th Cir.2003).

VI

We decide the issues in this case in a distinctive statutory context. We explained this context in *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir.1993):

> When the Commission sues to enforce the securities laws, it vindicates public rights and furthers the public interest. The public character of Commission action is reflected in the introduction to the 1934 Act: "[T]ransactions in securities . . . are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions." 15 U.S.C. § 78b. Congress entrusted the Commission with the vital mission of ensuring the honesty and fairness of the capital markets. "The entire purpose and thrust of a [Commission] enforcement action is to expeditiously safeguard the public interest by enjoining securities violations. The claims asserted in such an action stem from, and are colored by, the intense public interest in [Commission] enforcement of these laws." *SEC v. Asset Management Corp.*, 456 F.Supp. 998, 1000 (S.D.Ind.1978).

Given this context and the narrowly defined, regulated, and targeted area to which it applies, we conclude that Congress' use of the term "extraordinary" in Section 1103 in connection with payments being made by a company to insiders during an investigation for potential securities fraud—read in the light of the remedial purposes of federal securities laws—does not constitute a legal or a constitutional infirmity. "Extraordinary"

means, in plain language, out of the ordinary. In the context of a statute aimed at preventing the raiding of corporate assets, "out of the ordinary" means a payment that would not typically be made by a company in its customary course of business.[2] The standard of comparison is the company's common or regular behavior. Thus, the determination of whether a payment is extraordinary will be a fact-based and flexible inquiry. Context-specific factors such as the circumstances under which the payment is contemplated or made, the purpose of the payment, and the size of the payment may inform whether a payment is extraordinary, as the district court properly noted in this case. For example, a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances. *See* BLACK'S LAW DICTIONARY 586 (6th ed.1990) (defining "extraordinary" as "[o]ut of the ordinary; . . . employed for an exceptional purpose or on a special occasion").

A nexus between the suspected wrongdoing and the payment itself may further demonstrate that the payment is extraordinary, although such a connection is not required. Evidence of the company's deviation from an "industry standard"—or the practice of similarly situated

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[2] We have taken a similar approach in interpreting the analogous phrase "extraordinary expenses." *See, e.g., Atlanta-One, Inc. v. SEC*, 100 F.3d 105, 107-108 (9th Cir.1996) (noting that "extraordinary expenses" of a business could not justify very high commission fees); *In re United States Trustee*, 32 F.3d 1370, 1374 (9th Cir.1994) (noting that, for reimbursing a trustee in bankruptcy, the "extraordinary expenses" are those "associated with the *special needs* of an individual case."); *Frito-Lay, Inc. v. Local Union No. 137, Int'l Bhd. of Teamsters*, 623 F.2d 1354, 1365 n. 11 (9th Cir.1980) ("In addition to lost profits, an injured employer is entitled to recover the extraordinary expenses, not normal *to its business operation*, incurred as a result of the Union's illegal strike.") (emphasis added).

businesses—also might reveal whether a payment is extraordinary. Again, however, the statute does not compel any specific method of making the determination but allows for the consideration of a variety of factors, as the situation may warrant.

The district court had it exactly right in reading this statute, " 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' " *SEC v. Zandford,* 535 U.S. 813, 819, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002) (quoting *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 195, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963)). The court avoided any "one litmus test" and instead looked *in context* at (1) the circumstances of the payment, (2) the purpose of the payment, and (3) the size of the payment. The court concluded in a thorough, thoughtful, and well-reasoned decision that the Commission "has met its burden" "under almost any standard."

The court correctly focused on the nature, purpose, and circumstances of the payments and determined that they had nothing to do with Gemstar's ordinary business. The court accurately observed that

> [t]he payments were negotiated over a five month period and involved the participation of the Gemstar Board, a Special Committee, and outside consultants. The Board, the Special Committee, and the Intervenors Yuen and Leung were each represented by separate sets of counsel. Additionally, the termination agreements were executed as part of the process of removing both Leung and Yuen from their positions as Gemstar Officers.

The court concluded that the termination agreements and the disputed payments "are anything but ordinary." We agree. Using as a measure what ordinarily goes on in

the process of the issuer's business, these facts are clearly unusual and extraordinary. As the Commission's supplemental memorandum points out, the negotiated Termination Agreement payments here are five and six times greater than Yuen's and Leung's base salary, the component amounts that make up the lump sum payments are different than the amounts due under their employment agreements, the termination fees are different from what they may have been entitled to under existing agreements, the bonuses appear to be fruit of the alleged fraudulent financial results, and the vacation pay item did not exist under their contracts. One would not expect benefits like these to be flowing from corporate assets to executives resigning under fire from key management positions. This scenario is not business as usual. Telling also is the glaring fact that CEO Yuen would not discuss these matters with the Commission, choosing instead to assert his Fifth Amendment privilege. *See SEC v. Colello,* 139 F.3d 674, 677 (9th Cir.1998) ("Parties are free to invoke the Fifth Amendment in civil cases, but the court is equally free to draw adverse inferences from their failure of proof.").

Finally, we discern—as did the district court—that a nexus between the alleged wrongdoing and the contemplated payments was apparent from the Commission's submissions. As the district court said, "the bonuses are keyed to Gemstar's financial performance—the accuracy of which is alleged to have been compromised by the Intervenors."

We believe, as did the district court, that Gemstar's execution of *its* overall business objectives and ordinary management of *its* business operations did not entail terminating its CEO and CFO in the shadow of misstated revenues, misleading public statements, securities fraud investigations, plunging stock prices, and public rela-

tions debacles, not to mention Yuen's and Leung's inability to certify Gemstar's books as accurate. Gemstar's Form 8-K filings certainly raise red flags the SEC would be remiss to ignore.

The dissent suggests that to establish what is "extraordinary," the government must offer evidence of what constitutes "usual or ordinary payments to a CEO and a CFO under same or similar circumstances," i.e., payments contemplated under threat of delisting, in a fight with its independent auditor; and during an investigation for having misstated revenues, cooked the books, defrauded investors, employees and the market, and possibly committed a basket full of crimes. We respectfully disagree. The idea that a court needs somehow to have evidence of a "norm for corporate decision-making *of this type*," i.e., rampant fraud and a world of trouble, is off the mark. Odd it would be indeed to shield payments from escrow simply because an ousted insider at some other corporation has been similarly enriched. In some cases, it might be probative to look to a broader norm, but not here. Legal "probable cause" statements, of which this is a variant, do not need information about how normal people act to create a reasonable suspicion with respect to the targeted suspects. *See Go Leasing, Inc. v. NTSB*, 800 F.2d 1514, 1518 (9th Cir.1986) ("Agencies charged with a prosecutorial function must have flexibility in confronting the varieties of facts presented in particular cases.").

These insiders appear, from the record submitted to the district court, to be part of an enterprise engaged in cookie jar mismanagement. The Commission subsequently sued them for multiple securities fraud violations, seeking anti-fraud injunctions, civil money penalties, and disgorgement of ill-gotten gains, including salaries, bonuses, and proceeds from the sale of

stock—each one of which is at the epicenter of the payments at issue. The Commission's complaint alleges that because their compensation was linked to Gemstar's reported financial results, Yuen and Leung reaped millions of dollars in financial gains—in excess salary, bonuses, and options—from their fraudulent manipulations of Gemstar's revenues, to the tune of an overstatement of those revenues by at least $223 million.

Congress designed Section 1103 to add necessary teeth to the Commission's ability to perform its mission. It ensures that recovery by way of disgorgement, etc., is effective rather than empty. As for the importance of disgorgement, we have said:

> Disgorgement plays a central role in the enforcement of the securities laws. The effective enforcement of the federal securities laws requires that the Commission be able to make violations unprofitable. The deterrent effect of a Commission enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits. By deterring violations of the securities laws, disgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets. Although the Commission at times may use the disgorged proceeds to compensate injured victims, this does not detract from the public nature of Commission enforcement actions: the touchstone remains the fact that public policies are served and the public interest is advanced by the litigation.

Rind, 991 F.2d at 1491-92 (citations, internal quotations, and alterations omitted).

VII

Having concluded that Gemstar's payments to Yuen and Leung constitute "extraordinary payments" within the meaning of Section 1103, we turn to the Appellants' argument that Section 1103 is unconstitutionally vague. Our analysis must begin with a presumption in favor of the constitutionality of an act of Congress. *Parker v. Levy,* 417 U.S. 733, 757, 94 S.Ct. 2547, 41 L.Ed.2d 439 (1974). With this principle in mind, we conclude (1) that Section 1103 is not void for vagueness as applied to Yuen or Leung, and (2) that because Section 1103 does not concern First Amendment issues, Yuen and Leung's facial challenge fails as well. *See United States v. Mazurie,* 419 U.S. 544, 550, 95 S.Ct. 710, 42 L.Ed.2d 706 (1975) ("It is well established that vagueness challenges to statutes which do not involve First Amendment freedoms must be examined in the light of the facts of the case at hand.").

As the SEC points out, statutes that regulate businesses do not require the same precision as statutes addressing constitutional and criminal issues. In *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.,* 455 U.S. 489, 102 S.Ct. 1186, 71 L.Ed.2d 362 (1982), the Supreme Court held:

> [E]conomic regulation is subject to a less strict vagueness test because its subject matter is often more narrow, and because businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action. Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process.

Id. at 498, 102 S.Ct. 1186 (footnotes omitted); *see also Papachristou v. City of Jacksonville,* 405 U.S. 156, 162, 92 S.Ct. 839, 31 L.Ed.2d 110 (1972) ("In the field of regulatory statutes governing business activities, where the acts limited are in a narrow category, greater leeway is allowed."); *Botosan v. Paul McNally Realty,* 216 F.3d 827, 836 (9th Cir.2000) ("Because the ADA is a statute that regulates commercial conduct, it is reviewed under a less stringent standard of specificity."). Under this less stringent standard, the Appellants' void for vagueness argument lacks merit. A statute is unconstitutionally vague if it fails one of two tests: "First, if it fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits. Second, if it authorizes or even encourages arbitrary and discriminatory enforcement." *Hill v. Colorado,* 530 U.S. 703, 732, 120 S.Ct. 2480, 147 L.Ed.2d 597 (2000). Yuen and Leung cannot show that Section 1103 fails either test.

VIII

We conclude that the district court was correct in its understanding of the meaning of "extraordinary payments" and in the application of that flexible standard to the facts and circumstances of this case. Wisely, we believe, both Congress and the SEC have avoided creating a specific litmus test that determines what is or is not an "extraordinary payment." To do so for all possible situations would be next to impossible and would serve only to guide corporate scoundrels searching for ways to circumvent this salutary law.

AFFIRMED.

REINHARDT, Circuit Judge, concurring in the result, with whom GRABER, Circuit Judge, joins:

I agree that the severance packages in question are "extraordinary payments." I do not believe, however, that Congress intended courts to apply a vague and multi-faceted test that requires consideration of the purpose, circumstances, and size of the benefits, as well as other more complex factors, when determining whether to grant a temporary order escrowing such one-time payments for a short period of time while the SEC makes its decision regarding the filing of formal charges. Rather, employing a well-established meaning of the word "extraordinary," I would hold that *all* severance packages due top corporate officers and officials, and any other substantial non-routine payments to which they may be entitled, constitute "extraordinary payments" that the district court may order placed in escrow temporarily.

Section 1103 is a prophylactic provision intended to maintain the financial status quo of companies under investigation. As Senator Lott, sponsor of the provision, explained, its purpose is to "freeze[ ] payments of potential wrongdoers . . . [by] imposing a 45-day freeze on extraordinary payments to corporate executives." Floor Statement of then Senate Majority Leader Lott, 148 Cong. Rec. S6545 (July 10, 2002) (emphasis added). In order to effectuate the broad remedial purpose of the Sarbanes-Oxley Act, section 1103 authorizes the SEC to freeze any payments that are not made in the course of ordinary business operations and that might adversely affect the SEC's ability to protect the shareholders of a company under investigation. The freeze is intended to ensure that disgorgement and other remedies will be available should corporate financial wrongdoing be established. Complementing section 1103's "freezing" of

certain funds of a company under investigation, the "extraordinariness" requirement ensures that individuals will continue to receive their regular salaries and benefits and that the company will not be restricted in its usual and ordinary day-to-day operations during the pendency of the investigation. In contrast, the severance of a corporate executive, such as a CEO or a CFO, and the payment of benefits related to that severance, is, by definition, "extraordinary": it is uncommon, unusual, and, ultimately, not a part of the regular day-to-day business of the company.[1]

This interpretation of section 1103 is well-supported. It accords with a common and well-established definition of "extraordinary." *See e.g.*, Black's Law Dictionary 406 (6th ed. (abridged) 1991) (defining "extraordinary," *inter alia*, as "employed for an exceptional purpose or on a special occasion"); Oxford English Dictionary (2d ed.1989) (defining "extraordinary," *inter alia*, as being "[o]ut of the usual or regular course of order . . . exceptional; unusual; singular."). It is corroborated by the Congressional record. *See, e.g.*, Floor Statement of Senator Lott, 148 Cong. Rec. S6545 (daily ed. July 10, 2002) (complaining that executives were receiving "rewards," "corporate assets . . . [for] personal benefit," and "increased payments," "[w]hile an SEC investigation is underway"); Floor Statement of Representative Sensenbrenner 148 Cong. Rec. H4685 (daily ed. July 16, 2002) (stating that under this legislation, "top executives

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[1] As Judge Trott's opinion for the court points out, *see ante* at 1035, we have recently experienced a tidal wave of corporate accounting scandals. Although the government tends, unabashedly, to give medals to high-ranking officials whose missions have ended in disaster, corporations are more likely to give extravagant bonuses to such individuals, while inviting them to leave so as to avoid further public embarrassment.

will not be allowed to pilfer the assets of the company by giving themselves huge bonuses and other extraordinary payments if the company is subject to [an] SEC investigation. Their pay and benefits are frozen when the investigation starts").[2] Lastly, a bright-line rule comports with the purpose of the Act, particularly in light of the early stage of the investigation at which the SEC would ordinarily need to invoke section 1103, a stage at which the agency is yet to develop much of the relevant information. *See* Floor Statement of Representative Baker, 148 Cong. Rec. H4683-01 (daily ed. July 16, 2002) (noting that section 1103 allows "the SEC to freeze extraordinary payments until appropriate investigation may be concluded to determine whether such payments were warranted or not." (emphasis added)). As the SEC puts it, "complex proceedings are inimical . . . to the purposes of Section 1103" when the "investigation remains nascent or incomplete, and on an expedited (often emergency) basis."[3]

Irrespective of how common the termination of a CEO, CFO, or any key employee may be in the business world at large, or even at the particular company under investigation, the termination itself, and more important, the substantial severance package that so frequently accompanies it, *is* "extraordinary" under section 1103, because the event is not part of the regular day-to-day operations of the enterprise and the payments tend to disturb the financial status quo that the SEC is seeking to maintain. I see no need to weigh the amount of the

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[2] As the above statements from Congress illustrate, Congress referred to "bonuses," "rewards," and "increased payments," as "extraordinary payments." All are payments beyond a corporate executive's ordinary and customary salary or other compensation.

[3] Petition of the SEC for Rehearing and Rehearing En Banc, at 15.

severance package relative to the petitioners' base salary, or to assess whether the severance negotiations were suspicious or carried out in an "extraordinary" manner; nor do I see any need to examine any of the other factors the majority suggests may in some circumstances be relevant, such as the severance benefits of officers of other companies. Like the majority, I believe that Congress intended to "provide a strong shield for third-party creditors and corporate investors once the SEC begins an investigation of corporate malfeasance," *ante* at 1036. Contrary to the majority, however, I believe that whether there are suspicions of additional wrongdoing in the negotiation of the severance package, and whether the SEC can prove that any severance payments are connected with the pending investigation, is irrelevant to the question whether severance payments are "extraordinary" under the Act. If the purpose of section 1103 is, as the majority agrees, to prevent wrongdoers from depleting the corporate treasury and to ensure that there are adequate funds to provide for disgorgement should the allegations of fraud prove to be true, then an "extraordinary" payment would still be extraordinary even though it simply matched the executive's base annual salary, which in most cases would be in the millions. Similarly, the payment would be extraordinary even though the terms and amount were established entirely and unambiguously by pre-negotiated provisions incorporated in an employment contract long before the investigation commenced and even though no further negotiations whatsoever transpired after the first hint of scandal. In short a severance payment is an extraordinary payment regardless of the circumstances.

Of course, just because all severance payments are extraordinary does not mean that all such payments will be automatically frozen when an investigation starts.

Indeed, the SEC has the discretion to decide whether a particular extraordinary payment should be placed in escrow, and whether to request an escrow order from a federal judge. In making that decision it will undoubtedly consider whether, on the basis of the limited facts available to it, a particular freeze order is necessary or desirable to protect the public interest. Also, if, ultimately, the investigation does not lead to a charge by the SEC, any escrowed payment is released, while if a charge against the company is filed, the individual affected by such a freeze may petition a federal court for review of the order.

The clear-cut rule established by section 1103 provides an orderly and efficient method of effectuating Congress' intent while giving firm guidance to companies that are under investigation. The risk that in the absence of a freeze the SEC will be unable to achieve its objective of protecting the public interest because it cannot recoup the extraordinary payments made to high-ranking corporate officers or officials substantially outweighs the limited inconvenience a temporary freeze imposes upon the issuer and the would-be recipient of the extraordinary payment. In my opinion, Congress did not intend that before the SEC may freeze a severance payment for 45 or 90 days, it must satisfy the "extraordinariness" standard by presenting a substantial body of evidence to a court regarding the purpose, circumstances, and size of the particular payment. I would hold that under section 1103, all severance packages due to corporate executives fall into the category of "extraordinary payments" and are subject to a temporary freeze when the company in question, or those acting on its behalf, are under investigation for serious securities violations. For this reason, I agree that the order freezing

the severance payments of Yuen and Leung must be affirmed.

BEA, Circuit Judge, dissenting:

We are called upon to interpret the phrase "extraordinary payments" found in Section 1103 of the Sarbanes-Oxley Act. 15 U.S.C. § 78u-3(c)(3)(A)(i). In my view, the majority errs in two regards.

First, the majority interprets "extraordinary payments" to mean "payments under extraordinary circumstances." *See* Maj. Op. at 1044-46. This first step enables the majority to take account of a variety of circumstances (such as the fact that the payments at issue were made "in the shadow" of conduct ultimately giving rise to the SEC's investigation) that are only indirectly related (or, in some cases, not related at all) to the payments at issue. *See id.* at 1046. Of course, it is perfectly proper for the SEC to consider such circumstances in deciding whether to initiate an investigation regarding possible violations of the federal securities laws. But by also conscripting these and similar circumstances to render payments "extraordinary," the majority violates basic canons of statutory construction, rewriting the statute and, in so doing, rendering the very term at issue surplusage.

Second, by establishing as the principally relevant standard whether the circumstances surrounding the payments at issue are "extraordinary" not for other companies, but for the company making the payments, *any* payment made under *any* situation novel to *that* company is now subject to escrow. Thus, the first time a company under SEC investigation gives a departing executive not a golden parachute, but a mere gold watch

(or, even, a gold-plated watch), escrow will be available to the SEC. This alone renders the majority's standard unworkable. But the majority then exacerbates the problem by conceding that comparison to the industry or other companies may also be relevant in some circumstances, thereby creating a second standard but without providing any guidance as to when each of these potentially conflicting standards applies.

Reading the statute as it is written rather than as some may wish it had been written and applying what is a workable standard, I continue to believe the SEC must present evidence that a payment was extraordinary relative to payments made by other comparable companies, under circumstances which have not resulted in an investigation by securities agencies, but which are otherwise comparable. Because the SEC presented no such evidence, I would vacate the district court's order and remand to permit the SEC the opportunity to present appropriate evidence. Accordingly, I respectfully dissent.

I.

Before I address what I regard as the majority's two errors in interpreting the statute, it is important to set the record straight as to what is at stake. The majority describes the escrow as "nothing more onerous than a temporary order requiring the issuer under scrutiny to escrow those intended payments to a clearly defined group of insiders for no more than 45 days in a very familiar device, an interest-bearing account—all of this subject to court supervision." Maj. Op. at 1035. This is, at best, a naive view—blinkered from what can and did happen in this case. Once the subject of an investigation is charged with a securities violation by the com-

mencement of a civil action, "the [escrow] order shall remain in effect, subject to court approval, *until the conclusion of any legal proceedings related thereto . . . .*" 15 U.S.C. § 78u-3(c)(3)(B)(i) (emphasis added). Here, the district court's initial escrow order was effective as of May 9, 2003. Nearly two years have passed, and Yuen's and Leung's payments remain in escrow.

II.

Section 1103 provides in relevant part:

> Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make *extraordinary payments* (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

15 U.S.C. § 78u-3(c)(3)(A)(i) (emphasis added). Congress did not define "extraordinary payments."[1] Nor

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[1] When Congress wants to "cap" termination payments, it certainly knows how to do it with unquestionable precision. *See, e.g.*, 11 U.S.C. § 502(b)(7) (capping an employee's claim for damages resulting from the termination of an employment agreement when the employer has filed for bankruptcy to (1) one year's compensation provided by such contract measured from the earlier of the date of the filing of the bankruptcy petition or the date of termination, plus (2) any unpaid compensation due under such contract owing on such date).

has the SEC promulgated regulations doing so, although it is empowered to adopt regulations for the implementation of the Sarbanes-Oxley Act. 15 U.S.C. § 78w(a)(1).

Thus, purporting to rely on the statute's "plain language," Maj. Op. at 1045, but presumably influenced by what it perceives to have been Congress' intent in enacting Section 1103, *id.* at 1035-36, the majority defines "extraordinary payments" as those "that would not typically be made by a company in its customary course of business." *Id.* at 1045. Continuing, the majority explains that "[c]ontext-specific factors *such as the circumstances under which the payment is contemplated or made* . . . may inform whether a payment is extraordinary"—indeed, that "*a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances* "—and, thus, that the district court correctly focused not only on the size of the payment, but also on "the circumstances of the payment" and "the purpose of the payment." *Id.* at 1045 (emphasis added); *accord id.* at 1046 ("The court correctly focused on the nature, purpose, and circumstances of the payments . . . ."). Finally, in affirming the district court's order, the majority concludes:

> We believe, as did the district court, that Gemstar's execution of its overall business objectives and ordinary management of its business operations did not entail terminating its CEO and CFO in the shadow of misstated revenues, misleading public statements, securities fraud investigations, plunging stock prices, and public relations debacles, not to mention Yuen's and Leung's inability to certify Gemstar's books as accurate. Gemstar's Form 8-K filings certainly raise red flags the SEC would be remiss to ignore.

Id. at 1046 (emphasis in original); *accord id.* at 1046 ("Using as a measure what ordinarily goes on in the process of the issuer's business, these facts are clearly unusual and extraordinary.").

In so interpreting the statute, the majority errs in two regards.

A.

First, the majority's interpretation violates basic canons of statutory construction. To begin, the majority has not so much interpreted the statute as it has rewritten it. As explained above, the majority's interpretation of "extraordinary payments" amounts to "payments under extraordinary circumstances." *See* Maj. Op. at 1045-46. Indeed, the majority itself explains that "a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances." *Id.* at 1045. Thus, under the majority's interpretation, *any* payment following "extraordinary circumstances" may be subject to escrow. Yuen and Leung could have been paid $1 or $1 billion—it would make no difference to the majority.

But this simply is not what the statute says. As the statute is written, "extraordinary" modifies "payments"; as the majority has rewritten it, "extraordinary" modifies the circumstances under which the payments were made. To put it bluntly, where in the statute is the word "circumstances"? Moreover, the majority has not only inserted words into the statute, it has rearranged the remainder of it. This we cannot do, even for the laudable purpose of giving effect to important public interests:

> Our concern for the protective purposes of remedial legislation . . . does not vest this court with a license to rewrite the statute, for "our problem is to

> construe what Congress has written. After all, Congress expresses its purpose by words. *It is for us to ascertain—neither to add nor to subtract, neither to delete nor distort." 62 Cases, More or Less, Each Containing Six Jars of Jam v. United States*, 340 U.S. 593, 596, 71 S.Ct. 515, 518, 95 L.Ed. 566 (1951). "Our compass is not to read a statute to reach what we perceive—or even what we think a reasonable person should perceive—is a 'sensible result'; *Congress must be taken at its word unless we are to assume the role of statute revisers." Bifulco v. United States*, 447 U.S. 381, 401, 100 S.Ct. 2247, 2259, 65 L.Ed.2d 205 (1980).

United States v. Smith, 740 F.2d 734, 738 (9th Cir.1984) (emphasis added) (internal parentheticals omitted); *see also Xi v. INS*, 298 F.3d 832, 839 (9th Cir.2002) ("[A] decision to rearrange or rewrite the statute falls within the legislative, not the judicial, prerogative."); *Lewis v. McAdam*, 762 F.2d 800, 804 (9th Cir.1985) ("We have no constitutional authority to rewrite a [securities] statute simply because we may determine that it is susceptible of improvement.") (citing *Badaracco v. Commissioner*, 464 U.S. 386, 398, 104 S.Ct. 756, 78 L.Ed.2d 549 (1984)).

Further, given the circumstances the majority finds relevant, the majority's interpretation renders "extraordinary" surplusage. According to the majority, that the payments here were made "in the shadow of misstated revenues, misleading public statements, securities fraud investigations, plunging stock prices, and public relations debacles," "Yuen's and Leung's inability to certify Gemstar's books as accurate[,][and] Gemstar's Form 8-K filings" are all indicia that the payments here were "extraordinary"—or, more accurately, made under extraordinary circumstances. Maj. Op. at 1046.

Some of these factors are certain to be present any time the SEC investigates a company for possible violations of the federal securities laws, and the rest are likely to be present. But the escrow provision is, in any event, applicable only when "during the course of a lawful investigation involving *possible violations of the Federal securities laws* " it appears to the SEC that "extraordinary payments" are to be made. 15 U.S.C. § 78u-3(c)(3)(A)(i) (emphasis added). Thus, by defining "extraordinary" to mean little if anything more than that circumstances exist that might give cause to the SEC to initiate a lawful investigation, "extraordinary" serves no independent modifying purpose. Each payment made in the midst of circumstances likely to lead to an SEC investigation becomes made under "extraordinary circumstances," therefore an "extraordinary payment." Hence, the majority's interpretation violates the " 'cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' " *TRW Inc. v. Andrews,* 534 U.S. 19, 31, 122 S.Ct. 441, 151 L.Ed.2d 339 (2001) (quoting *Duncan v. Walker,* 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001)).

Congress could have written the statute differently. The SEC might have been able to promulgate regulations so interpreting the statute. Congress didn't, the SEC hasn't, and we mustn't.[2]

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[2] I can only assume that the majority's insouciance for these canons of statutory construction stems from its desire to give effect to what it perceives as Congressional intent. Setting aside the principle that Congress' words are the best evidence of its intent, the majority's description of Congress' intent in enacting Section 1103 does not support the majority's interpretation of "extraordinary payments." According to the majority, Congress' purpose in enacting

B.

Second, even had the majority not rewritten the statute and, indeed, written the very term at issue out of the statute, its interpretation is unworkable as a practical matter. The majority first interprets "extraordinary payments" as those "that would not typically be made by a company in *its* customary course of business," Maj. Op. at 1045 (emphasis added). Thus, as the majority explains, "[t]he standard of comparison is *the company's* common or regular behavior." *Id.* (emphasis added). This alone raises a significant practical concern. Presumably, terminating the CEO's and CFO's employment is never done "by a company in *its* customary course of business." *Id.* (emphasis added). I think we can all agree that these events do not occur, for any given business, each Monday morning as the doors open for business. Does this mean, then, that any payment to a departing CEO, CFO or, for that matter, any officer or director may be

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Section 1103 was to prevent "persons, companies, and pensions plans" from being "left holding an empty bag" while, by contrast, corporate insiders are well compensated. Maj. Op. at 1036 "By the time the authorities have been alerted to the fraud," explains the majority, "it's too late [because] the assets of the company have already disappeared. . . . In the meanwhile, the disappearance of such funds impoverishes and damages the issuer itself. . . ." *Id.* at 1035. Likewise, the majority quotes Representative Sensenbrenner's explanation that Section 1103 would prevent "top executives" from "pilfer[ing] the assets of the company." *Id.* at 1036 (citing 148 Cong. Rec. H4685 (daily ed. July 16, 2002)). If it was assets "disappear[ing]" and being "pilfer[ed]" while people and pension plans were left holding an "empty bag" and issuers were "impoverishe[d]" that so concerned Congress, wouldn't the size of the payment rather than the circumstances surrounding the payment have been of utmost importance? Tellingly, although he did not limit "extraordinary payments" to "huge bonuses," Representative Sensenbrenner identified no other example of an "extraordinary payment[ ]."

subject to escrow? As mentioned before, even if the payment is not a golden parachute, but a mere gold watch (or even a gold-plated watch)? Can this really be what Congress meant by "extraordinary"? And if not, upon what articulable principle ingrained in the standard adopted by the majority could we arrive at a contrary conclusion?[3]

This practical concern is made worse by the majority's concession that we must do more than compare what the subject company is doing now merely with what it has done in the past. From a company-specific test, the majority daintily dips its toe in Lake Eversharp:[4] "Evidence of the company's deviation from an 'industry stan-

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[3] The majority cites three cases for the proposition that this court has previously relied on evidence of a company's own past practices to determine "extraordinary expenses." Maj. Op. at 1045 n. 2. In the first, the court held that a brokerage firm's commissions were excessive because "[n]o *reasonable* broker could think it could fairly charge commissions so high" and rejected the brokerage firm's asserted defense that it "provided *unique* and *special* services and [thus] incurred [relatively] high expenses." *Atlanta-One, Inc.* v. SEC, 100 F.3d 105, 107-08 (9th Cir.1996) (emphasis added). In other words, the court compared the brokerage firm's commissions and expenses not to its prior practice, but to what the "reasonable" broker might charge and to what services were typically offered in the industry. That is what should happen here. In the remaining two cases, the governing statute or rule of law called for a comparison between the expense claimed extraordinary and the company's past practice. *In re United States Trustee*, 32 F.3d 1370, 1374 (9th Cir.1994) (bankruptcy trustees seeking reimbursement of expenses); *Frito-Lay, Inc. v. Local Union No. 137, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America*, 623 F.2d 1354, 1365 n. 11 (9th Cir.1980) (company suing for damages resulting from an unlawful strike). Of course, Gemstar had no such past practice; the cited cases are inapposite.

[4] The Eversharp Company used to advertise its wares: "Compare! Comparison proves!".

dard'—or the practice of similarly situated businesses—also might reveal whether a payment is extraordinary." *Id.* at 1045. Well, which one is it? What the subject company has done in the past or what other companies have done? That is, is the test internal to the subject company or external to practices of the industry in which the company competes? What if under the internal test the payment is not extraordinary, but under the external test it is? Or vice-versa? Does the internal trump the external, or is it the other way around? Or, must the payment be extraordinary under both tests? Are we going to say nothing more than that the matter will be dealt with on a "case-by-case" basis, that favorite ploy to avoid a statement of principle?

The majority takes refuge in its assertion that "the statute does not compel any specific method of making the determination but allows for the consideration of a variety of factors, as the situation may warrant," *id.*, and in its mandate that "the determination of whether a payment is extraordinary will be a fact-based and flexible inquiry." *Id.* at 1045. Standards that call for an evaluation of the totality of the circumstances are, of course, well known to the law, but they are workable only when those circumstances are compared against a known, fixed standard. Here, by contrast, the majority proffers two standards that, depending on the facts of the case, may very well conflict.

III.

Because as the statute is written "extraordinary" modifies "payments" rather than the circumstances under which those payments were made, and because the majority's standard principally requiring a comparison to the past practice of the company at issue is unwork-

able, I must interpret "extraordinary payments" to mean payments not usual or ordinary relative to those made by other comparable companies, under circumstances which have not resulted in an investigation by securities agencies, but which are otherwise comparable. Factors to be considered in identifying comparable companies may include their size (measured in terms of annual revenues, annual net profit, market capitalization, some other appropriate measure, or a combination of these considerations)[5] and the industry or market in which they do business.[6] Relevant comparable circumstances may include the position of those whose employment is being terminated, the length of their tenure, and the reason their employment was terminated. However, I reiterate that the comparison should *not* be to payments made by other companies that were engaged in conduct which

[5] Such financial measures of the revenue size of the company that made the payments at issue may be artificially inflated as a result of the securities violations in which it is alleged to have engaged. Appropriate adjustments should and can be made to compensate for this.

[6] No two companies are identical, but adjustments can be made to compensate for any material peculiarities of a given company. Comparisons of this sort are daily made, for example, in equalization of property tax assessments in the real property field, where the value of a subject property is determined by the value of comparable properties as measured by such factors as the square footage, location, size of buildings and probable income. After determination of comparability, adjustments are made to compensate for peculiarities individual to the subject property. Thus, for example, if the subject property has a *lis pendens* or an unrecorded easement claimed against it, the value will likely be adjusted downwards. A similar method is used in condemnation actions. Likewise, in the field of traded securities, the market adjusts stock prices for companies with comparable earnings, but with, for example, dissimilar litigation or investigational backgrounds.

ultimately resulted in investigation by securities agencies.[7]

Nor is this an undertaking to which federal courts are unaccustomed or for which they are ill-equipped. Legislation which uses relative adjectives to proscribe activities is hardly unknown to the law. Statutes and law commonly prohibit "excessive" verdicts and sanction "unreasonable" behavior. *E.g., State Farm Mutual Automobile Insurance Co. v. Campbell,* 538 U.S. 408, 416, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003) ("The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor."); Cal.Civ.Proc.Code § 657 (permitting modification or vacatur of a judgment where the award of damages is "[e]xcessive or inadequate"); Restatement (Second) of Torts § 282 (defining "negligence" as "conduct which falls below the standard established by law for the protection of others against unreasonable risk of harm"). It is not beyond the judiciary's capacity to interpret and apply statutes which prohibit "excessive" or "unreasonable" amounts. Indeed, trial and appellate courts are called upon to do so every day.[8] And, as is of

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[7] The majority, then, misstates my position when it states:

> The dissent suggests that to establish what is "extraordinary," the government must offer evidence of what constitutes "usual or ordinary payments to a CEO and a CFO under [comparable] circumstances," i.e., payments contemplated under threat of delisting, in a fight with its independent auditor; and during an investigation for having misstated revenues, cooked the books, defrauded investors, employees and the market, and possibly committed a basket full of crimes.

Maj. Op. at 1046.

[8] For instance, courts are often called upon to determine whether awards of attorney's fees are "reasonable." *See Pennsylvania v. Delaware Valley Citizens' Council for Clean Air,* 478 U.S. 546,

particular relevance here, courts are even asked whether some remuneration constitutes "extraordinary payment." An example is the line of cases which determines whether payments made by a corporation to an employee are deductible from gross income as "ordinary and necessary" business expenses or, rather, are "extraordinary payments" disallowed as a deduction. *See, e.g., Label-Graphics, Inc. v. IRS,* 221 F.3d 1091, 1095 (9th Cir.2000) (explaining that a corporation may deduct "a reasonable allowance for salaries or other compensation for personal services actually rendered" and noting as one of the factors relevant in making this determination "a comparison of the employee's salary with those paid by similar companies for similar services") (citing *Elliotts, Inc. v. IRS,* 716 F.2d 1241 (9th Cir.1983)).

562, 106 S.Ct. 3088, 92 L.Ed.2d 439 (1986) ("There are over 100 separate statutes providing for the award of attorney's fees; and although these provisions cover a wide variety of contexts and causes of action, the benchmark for the awards under nearly all of these statutes is that the attorney's fee must be 'reasonable.' "). " 'The most useful starting point for determining the amount of a reasonable fee is the number of hours reasonably expended on the litigation multiplied by a reasonable hourly rate,' " *id.* at 564, 106 S.Ct. 3088, and it is "[t]he fee applicant [that] has the burden of producing satisfactory evidence, in addition to the affidavits of its counsel, that the requested rates are in line with those prevailing in the community for similar services of lawyers of reasonably comparable skill and reputation." *Jordan v. Multnomah County,* 815 F.2d 1258, 1263 (9th Cir.1987). Likewise, courts daily determine what are "extraordinary" fees in probate courts across the country. But, unlike the district court here, those probate courts have elaborate statutes, rules of procedure and case authority to guide them in determining what services by estate representatives are "ordinary" (and covered by the statutory fees) and what expenses are "extraordinary," conferring entitlement to added fees. *See,* e.g., Cal. Prob.Code §§ 10801, 10811; Cal. Court R. 7.702; *In re Fulcher's Estate,* 234 Cal.App.2d 710, 718, 44 Cal.Rptr. 861, 866 (1965).

Whether the adjective is "excessive," "unreasonable" or "extraordinary," the cases in which those terms appear use similar processes of judgment. The trier-of-fact determines first what constitutes "adequate compensation," "reasonable care," or "customary or ordinary payments." Such determinations require evidence which consists of similar factual situations which can be compared to the case at hand. If the case at hand falls outside the bounds permitted in the comparison cases, that result is deemed "excessive," "unreasonable," or "extraordinary."

A.

Here, the SEC limited its proof in its Section 1103 application to an investigating attorney's affidavit. The affidavit—and consequently the record—is completely silent regarding what constituted usual or ordinary payments upon termination of a CEO and Chairman of the Board (Yuen) or COO and CFO (Leung) of companies with comparable financial statements and operating results. Undoubtedly, their payments were large—extraordinary, even, relative to what federal judges or, for that matter, most anyone is paid.[9] Such payments

[9] But not quite "anyone." For example, the *average* value of severance packages awarded in fiscal year 2000 to CEOs of companies in the S & P 500, conservatively calculated, is more than $11.4 million. *See* Paul Hodgson, *Golden Parachutes and Cushion Landings: Termination Payments and Policy in the S & P 500*, at 18-21 (2003). Of course, some CEOs are awarded severance packages that are worth many multiples of the average. E.g., Chad Terhune et al., "Coke Tradition: CEOs Go Better With a Fat Send-Off," *Wall Street Journal*, June 11, 2003, at B1 (reporting M. Douglas Ivester's "exit package" upon being "ousted" as Chairman and CEO of Coca-Cola in February 2000 as $119 million); Sam Zuckerman, "The Fall and Rise of David Coulter," *San Francisco Chronicle*, May 25, 2002, at A1

may be called "golden parachutes" or "golden handshakes" in the press, but purple prose is not enough to prove a statutory requirement in court. For enforcement of the securities laws of the United States, *evidence* of what is usual or ordinary for comparable companies under circumstances which have not resulted in an investigation by securities agencies but which are otherwise comparable, is necessary to distinguish "extraordinary payments" and to order their escrow pursuant to Section 1103. Such evidence was not adduced in the district court; that absence requires the reversal of the judgment of the district court.[10]

B.

The remaining factors on which the majority relies are either irrelevant or fail to evidence that the payments here were extraordinary. Thus, because I interpret "extraordinary" to modify "payments" rather than the circumstances under which those payments were made, that " 'the termination agreements were executed as part of the process of removing both Leung and Yuen from their positions as Gemstar Officers,' " that "the bonuses appear to be fruit of the alleged fraudulent financial results," that the "executives [were] resigning under fire from key management positions," and that the payments were made "in the shadow of misstated revenues, mis-

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(reporting David Coulter's severance package after being "unceremoniously ousted" as CEO of Bank of America and "le[aving] San Francisco with his reputation in tatters" as "nearly $100 million").

[10] Nor, frankly, would requiring such evidence be particularly onerous for the SEC. Evidence in the form of expert testimony or an affidavit or declaration comparing the payments under scrutiny with other executives' compensation packages is readily ascertainable from public filings. *See supra* note 8.

leading public statements, securities fraud investigations, plunging stock prices, . . . public relations debacles, . . . [and] Yuen's and Leung's inability to certify Gemstar's books as accurate," Maj. Op. at 1046, is irrelevant. Likewise, because I believe that the relevant comparison is to other companies rather than to Gemstar's past practices, that the "negotiated Termination Agreement payments here are five and six times greater than Yuen's and Leung's base salary," that "the component amounts that make up the lump sum payments are different than the amounts due under their employment agreements," that "the termination fees are different from what they may have been entitled to under existing agreements," and that "the vacation pay item did not exist under their contracts," *id.* at 1046, also is, absent evidence of other companies' practices, irrelevant.

This, then, leaves only three factors on which the majority relies that at best serve as evidence that either Gemstar or Yuen and Leung themselves believed the payments to be extraordinary and, thus, as circumstantial evidence that they were extraordinary: (1) that " '[t]he payments were negotiated over a five month period and involved the participation of the Gemstar Board, a Special Committee, and outside consultants,' " and " '[t]he Board, the Special Committee, and the Intervenors Yuen and Leung were each represented by separate sets of counsel' "; (2) that "Yuen would not discuss these matters with the Commission, choosing instead to assert his Fifth Amendment privilege"; and (3) that Gemstar reported the terms of the termination agreements in a Form 8-K filing. *Id.* at 1046.

As for the negotiation of the termination agreements, nothing in the record suggests that this extended negotiation constitutes a deviation from the norm for corporate decision-making of this type under circumstances

not resulting in an investigation by securities agencies, but which are otherwise comparable. Indeed, for all the persons involved in the negotiations, not one presented evidence before the district court that the period or mechanics of the negotiations were out of the ordinary. While common experience of the district court might help to determine what is the usual way to negotiate the termination of a lawyer at a law firm or a staff member of the court, common experiences of this kind do not aid judgment with respect to the termination of Yuen's and Leung's employment with Gemstar.

Further, even on their own terms, these negotiations are not particularly suspicious given the context. To begin, as the declaration of Yuen's and Leung's counsel shows, GemstarTV Guide was the product of a merger between, on the one hand, an off-shore company founded by Yuen and Leung and, on the other, TV Guide, a subsidiary of News Corporation, itself a large telecommunications company. Yuen and Leung presented uncontradicted evidence that their revenue-producing strategies differed, if not clashed, with those of News Corporation. Whereas Yuen and Leung were interested primarily in raising revenue attributable to the corporation's sales, the minority owners, Gemstar's current management, were in part interested in publicizing one of their sister corporations through Gemstar's operations, without paying Gemstar any advertising revenue. Such a strategy would increase revenues for the sister corporation, but not for Gemstar. As owners and officers in Gemstar, Yuen and Leung would not share in the profits of the sister corporation.

In addition, in the event that Yuen or Leung were terminated "without cause," as they were, lengthy and complex employment agreements governed their termination payments. Yuen and Leung had three different compo-

nents for calculation of their Annual Incentive Bonuses. Complex enough when based on the company's past performance, computations also had to be done for future payments, with the consequent and predictable squabbling over methods for projecting future financial performance. Thus, in view of Gemstar's revenue structure, the conflicting strategies, and the complex schemes for computation of termination payments, it is not the least bit surprising that the negotiations pertaining to Yuen's and Leung's departures would be lengthy and that all interested parties would be represented by counsel.

As for Yuen asserting his Fifth Amendment privilege, it is hard to imagine what inference this raises given the context. Yuen had been the CEO of a company that the SEC was investigating for securities violations. It is more likely than not that his invocation says a great deal more about those alleged securities violations than it does about whether his payment was extraordinary.

Last, a Form 8-K filing is required from an "issuer of securities when substantial events occur. . . ." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 528 n. 6, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). In this era of heightened corporate vigilance, it is not surprising that Gemstar management should choose to make this report upon the termination of the founders of the company, who were being paid millions of dollars on departure in an amount approximating 15 percent of the previous year's revenues. But a discretionary corporate disclosure is not an admission that the company has paid an "extraordinary" amount. In any event, there was also no evidence of whether other "issuers" had made similar reports for similar sums paid to similarly departing upper management. A "substantial event" may or may not coincide with an "extraordinary payment." Only evidence of comparable events and circumstances can tell us.

IV.

The majority's interpretation of "extraordinary payments" may very well best empower the SEC to remedy the outrageous corporate misconduct that gave birth to the Sarbanes-Oxley Act. However, we are not a junior varsity legislature, *see Mistretta v. United States*, 488 U.S. 361, 427, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989) (Scalia, J., dissenting), and must take Congress at its word, *see Bifulco*, 447 U.S. at 401, 100 S.Ct. 2247, ever cognizant that Congress and the Judiciary alike are in the business of using language precisely. Where Congress fails to do so, it should not look to the Judiciary for a remedy—nor need it.

Section 1103 empowers the SEC to escrow "extraordinary payments," not payments made under extraordinary circumstances, particularly where "extraordinary circumstances" means little if anything more than that the company is under investigation for securities violations. Further, if it is to be a workable standard, the relevant comparison must be not to the company at issue, but to other comparable companies, under circumstances which have not resulted in an investigation by securities agencies, but which are otherwise comparable. Because the SEC failed to adduce any such relevant evidence, I would vacate the district court's order and permit the SEC the opportunity to do so. Accordingly, I respectfully dissent.

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No. 04-1723

In the Supreme Court of the United States

HENRY C. YUEN, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether termination payments of more than $37 million that petitioners' employer proposed to make to petitioners while their conduct was the subject of a Securities and Exchange Commission (SEC) investigation for securities fraud were "extraordinary payments" under Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 78u-3(c)(3)(A)(i) (Supp. II 2002).

2. Whether Section 1103 violates the Fourth Amendment.

3. Whether Section 1103 is void for vagueness as applied to petitioners, because the SEC did not tell them in advance whether it would seek to escrow the entire $37 million in termination payments.

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BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

OPINIONS BELOW

The en banc opinion of the court of appeals (Pet. App. 68a-123a) is reported at 401 F.3d 1031. The vacated panel opinion of the court of appeals (Pet. App. 23a-67a) is reported at 367 F.3d 1087. The June 20, 2003 memorandum decision of the district court (Pet. App. 1a-22a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 22, 2005. The petition for a writ of certiorari was filed on June 20, 2005. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 78u-3(c)(3) (Supp. II 2002), authorizes the Securities and Exchange Commission (SEC or the Commission) to freeze temporarily certain payments to corporate officers during the course of an investigation.[1] Under Section 1103, if during an SEC investigation it appears that an issuer of publicly traded securities will likely make "extraordinary payments (whether compensation or otherwise)" to a corporate insider under investigation, the SEC can petition a district court to place those payments in escrow for 45 days. 15 U.S.C. 78u-3(c)(3)(A)(i) (Supp. II 2002). That brief pre-litigation escrow can be extended, upon a showing of good cause, for 45 additional days, after which the escrow order may continue, with court approval, only if the SEC files suit before it expires. 15 U.S.C. 78u-3(c)(3)(A)(iv) and (B)(i) (Supp. II 2002). The temporary escrow order may be entered "only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest," 15 U.S.C. 78u-3(c)(3)(A)(ii) (Supp. II 2002), and any person affected by the temporary escrow order has the right to petition the court for relief, 15 U.S.C. 78u-3(c)(3)(B)(i). If the SEC does not seek to extend the escrow, the escrowed monies are released with accrued interest. 15 U.S.C. 78u-3(c)(3)(B)(ii). See Pet. App. 71a-72a.

2. Gemstar-TV Guide International, Inc. (Gemstar) is a publicly traded company that develops and licenses intellectual property and proprietary technologies, pub-

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[1] The text of Section 1103 is set out in full in the petition (at 2-4).

lishes *TV Guide* magazine, and operates the TV Guide Channel. Petitioner Yuen became Gemstar's Chief Executive Officer in 1994 and its Chairman of the Board in 1999. Petitioner Leung became Gemstar's Chief Financial Officer in 1994. In 2002, Gemstar began a series of corrections to substantial financial misstatements that it had made in public filings with the SEC while petitioners were at its helm. On April 1, 2002, Gemstar filed its Form 10-K for 2001, revealing that $107.6 million that Gemstar had previously claimed as revenue had not actually been realized. The filing also disclosed that Gemstar had improperly claimed substantial revenue from a "non-monetary transaction." Those revelations caused Gemstar's stock price to drop 37% the next day. Four days before the disclosure and resulting stock price decline, Yuen had sold 7 million Gemstar shares, receiving an initial payment of $59 million. SEC C.A. Br. 5-6; Pet. App. 74a-76a.

On August 14, 2002, Gemstar declared in a Form 8-K—a current report filed with the SEC to "announce major events that shareholders should know about," see http://www.sec.gov/about/forms/form8-k.pdf; 15 U.S.C. 78m(a)(1); 17 C.F.R. 240.13a-11—that it intended to restate its 2001 financial results and to reverse an additional $20 million in revenue and make other significant corrections. Gemstar attached sworn statements from petitioners that they were unable to certify the accuracy of some of Gemstar's financial statements, and that they were unable to comply with SEC orders to do so. Pet. App. 74a-75a.[2]

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[2] In June 2002, the SEC ordered the principal executive officer and principal financial officer of each company with annual revenues over $1.2 billion to file a report with the Commission regarding the accuracy of their company's financial statements and their consultation with the

On September 25, 2002, Gemstar filed another Form 8-K. In it, Gemstar disclosed that: NASDAQ had warned Gemstar that its securities were subject to delisting for failure to timely file a Form 10-Q for the quarter ending on June 30, 2002; because of its unresolved dispute with KPMG (its independent auditor), Gemstar could not file its Form 10-Q report; and any resolution of those accounting and financial matters was "uncertain" and "unpredictable." Pet. App. 75a.

At the same time that the accounting problems were coming to light, petitioners engaged in extensive negotiations with Gemstar's board of directors and eventually entered into an agreement in which they agreed to resign, effective November 7, 2002, from their respective executive positions. In return, Gemstar agreed to pay Yuen $29.48 million and Leung $8.16 million, and both of them remained as employees. The payments extinguished petitioners' rights under their existing severance packages, but did not reflect the payment amounts promised in those prior packages. Gemstar also agreed to give Yuen 5.27 million shares of restricted stock or stock units and to give Leung options to purchase over 1.1 million shares of common stock and 353,680 shares of restricted stock or stock options. Gemstar reported those developments on November 12, 2002, filing another Form 8-K. Pet. App. 76a.

After petitioners stated that they could not certify Gemstar's financial statements, the SEC began investigating Gemstar, petitioners, and others for possible securities-law violations. Upon learning in October 2002

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company's audit committees. See File No. 4-460; Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934 (June 27, 2002) <http://www.sec.gov/rules/other/4-460.htm>.

of the proposed $37 million in termination payments to petitioners, the SEC asked Gemstar and petitioners to place those payments in escrow. On November 6, 2002, shortly before the termination payments were to be made, Gemstar and petitioners signed side agreements providing that Gemstar would hold the monies in escrow until May 6, 2003. Pet. App. 5a, 26a-27a.

The SEC subpoenaed Yuen to testify in its investigation. Yuen appeared on April 1, 2003, for testimony and answered general background questions. He appeared again on April 23, but he invoked the Fifth Amendment privilege against self-incrimination, refusing to answer questions regarding any matters beyond his general background. SEC C.A. Br. 9-10 n.4; Pet. App. 82a.

3. On May 5, 2003, the day before Gemstar was scheduled to make the termination payments to petitioners, the SEC filed in the United States District Court for the Central District of California an *ex parte* application for a 45-day pre-litigation escrow under Section 1103, 15 U.S.C. 78u-3(c)(3) (Supp. II 2002), naming Gemstar (which held the funds) as respondent. Pet. App. 80a. The district court granted petitioners' request to intervene to resist the SEC's application for a 45-day escrow, afforded them an opportunity to file an opposition to the escrow, and held a hearing, at which it granted the SEC's application. After further briefing and an additional hearing, the district court issued an opinion setting forth its reasons for granting the SEC's application and denying petitioners' requests to dissolve the 45-day escrow. *Id.* at 6a, 27a-28a.

Before the 45-day escrow expired, the SEC filed a civil complaint against petitioners, charging that they had engaged in a fraudulent scheme to inflate Gemstar's revenues by at least $223 million. Pet. App. 28a. The

complaint also charged that, because their compensation was linked to Gemstar's reported financial results, petitioners reaped millions of dollars—in excess salary, bonuses, and options—from their fraudulent manipulation of Gemstar's revenues. The SEC also asked the district court to continue the escrow until the conclusion of legal proceedings pursuant to Section 1103, 15 U.S.C. 78u-3(c)(3)(B)(i).

On June 20, 2003, the district court issued an opinion rejecting petitioners' contentions that the termination payments were not "extraordinary payments" within the meaning of Section 1103, 15 U.S.C. 78u-3(c)(3)(A)(i). Pet. App. 1a-22a. The court explained that "Congress intended for the courts to look to a variety of factors to determine whether a payment is extraordinary," including "the size of the payment, the circumstances under which a payment is made, and the purpose of the payment." *Id.* at 13a. The court concluded that, whatever the outer bounds of the definition of "extraordinary payments," the payments at issue "fall squarely within" it. *Ibid.* The district court also rejected petitioners' contention that the statute was unconstitutionally vague. *Id.* at 13a-17a. The district court therefore entered an order continuing the escrow pursuant to Section 1103. SEC C.A. Br. 12-13; Pet. App. 28a.[4]

4. A divided panel of the court of appeals vacated the escrow, holding that the SEC had not shown that the termination payments to petitioners were "extraordinary payments" under Section 1103. Pet. App. 32a-39a. The court of appeals subsequently granted the SEC's

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[4] Petitioners stipulated that, once the SEC filed suit, the termination payments were to remain in escrow, even though the district court expressly noted that petitioners could petition the district court for relief from the escrow "[i]f they so desire." C.A.E.R. 379.

petition for rehearing en banc, see *SEC* v. *Yuen*, 384 F.3d 1090 (2004). On rehearing, the court of appeals affirmed the district court's entry of the escrow. Pet. App. 68a-123a.

The court of appeals rejected petitioners' contention that their negotiated termination payments were not "extraordinary payments" within the meaning of Section 1103. The court explained that "'[e]xtraordinary' means, in plain language, out of the ordinary." Pet. App. 92a-93a. The court further observed that "extraordinary" "means a payment that would not typically be made by a company in its customary course of business," *id.* at 93a. Because "[t]he standard of comparison is the company's common or regular behavior," *ibid.*, the court reasoned that "the determination of whether a payment is extraordinary will be a fact-based and flexible inquiry," *ibid.* That inquiry, the court explained, should take into account "the circumstances under which the payment is contemplated or made," its purpose, and its size. *Ibid.* The court identified a "nexus between the suspected wrongdoing and the payment," and the practices of similarly situated businesses as additional factors that a court could consider. *Id.* at 93a-94a.

The court of appeals further held that the district court had correctly applied this analysis in finding that the proposed termination payments were extraordinary. It observed that the termination payments to petitioners were far greater than their respective annual salaries; differed from the amounts of the severance payments under their employment agreements; appeared to be at least in part the fruit of Gemstar's "alleged fraudulent financial results"; were arrived at as part of petitioners' ouster from Gemstar management; and were reported by Gemstar in a Form 8-K filing with the SEC. Pet.

App. 95a-96a. The court of appeals also cited the "glaring fact" that Yuen invoked the Fifth Amendment rather than testify about his compensation. *Id.* at 95a.

Finally, the court of appeals rejected petitioners' Fourth and Fifth Amendment challenges to the escrow. The court held that the escrow procedures were reasonable under the Fourth Amendment and that Section 1103 was not unconstitutionally vague because it neither fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits, nor authorizes arbitrary and discriminatory enforcement. *Id.* at 70a n.1, 98a-99a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is not warranted.

1. Petitioners contend (Pet. 17-21) that the court of appeals adopted an overly broad definition of the phrase "extraordinary payments" as used in Section 1103 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 78u-3(c)(3). That contention is incorrect, and in any event does not merit review.

a. The court of appeals interpreted Section 1103 consistently with the plain meaning of the phrase "extraordinary payments," the historical context in which it was enacted, the legislative history, and the broader purposes of the federal securities laws. See *Household Credit Servs., Inc.* v. *Pfennig*, 541 U.S. 232, 239 (2004) (in ascertaining statute's plain meaning, courts "must look to the particular statutory language at issue, as well as the language and design of the statute as a whole"). As the court of appeals explained, "extraordinary" simply means "out of the ordinary; . . . employed for an

exceptional purpose or on a special occasion." Pet. App. 93a (quoting *Black's Law Dictionary* 586 (6th ed. 1990)); see also *Oxford English Dictionary* 614 (2d ed. 1989) (defining "extraordinary" to mean, *inter alia*, "|o|ut of the usual or regular course of order * * * exceptional; unusual; singular"). The court of appeals' reliance on factors such as the circumstances in which the payments would be made (here, in connection with petitioners' termination as officers), the size of the payments in relation to other benchmarks such as petitioners' base salary, and the purpose of the payments (here, as a settlement of disputed matters) is consistent with the plain-meaning understanding of "extraordinary."[1]

The flexible approach adopted by the court of appeals is consistent with this Court's observation that the Securities and Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, into which Section 1103 was incorporated, should be construed "flexibly to effectuate its remedial purposes." *SEC* v. *Zandford*, 535 U.S. 813, 819 (2002) (internal quotation marks omitted); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963). As the court of appeals recognized, Congress enacted Section 1103 to address the concern that the SEC's traditional remedies against corporate wrongdoers—disgorgement, civil penalties, and restitution—were of limited, if not illusory, value when the wrongdoers received corporate funds and were able to hide or spend them before the SEC could finish its investigation and file suit. Pet. App. 72a-73a. By eschewing "a specific litmus test that determines what is or is not an 'extraordinary payment,'" *id.* at 99a, the court of appeals' flexible approach effectuates

[1] By adopting this multi-factor approach, the court of appeals clearly did not establish a standard that "encompass[es] *any* payment to be made by a company under investigation by the SEC." Pet. 16.

Congress's intent to combat the dissolution of corporate assets in anticipation of an enforcement action.

The court of appeals' reading of Section 1103 is also supported by the statute's legislative history. For example, Senator Lott, Section 1103's sponsor, stressed that corporate executives had been receiving "rewards" "|w|hile an |SEC| investigation is underway," and that "corporate executives |were| taking increased payments, extraordinary payments, while they are being investigated." 148 Cong. Rec. S6542, S6545 (daily ed. July 10, 2002). Others members of Congress noted that if corporate executives "have manipulated the books and benefitted themselves," the SEC could use Section 1103 to freeze extraordinary payments "until appropriate investigation may be concluded to determine whether such payments were warranted or not." *Id.* at H4687 (daily ed. July 16, 2002) (statement of Rep. Baker); see generally Pet. App. 73a-74a, 101a-102a.

b. Petitioners urge (Pet. 17) an interpretation of "extraordinary payments" advanced by the dissent below, which would require the SEC to offer evidence of what constitutes "usual or ordinary" payments to a CEO and a CFO at a "comparable compan|y|" under "comparable circumstances." See Pet. App. 115a. Nothing in the text of Section 1103 suggests, however, that the SEC must establish that the payment is extraordinary in comparison to some general industry standard. Moreover, such an approach ignores the congressional purpose in enacting Section 1103 and would seriously undermine its utility.

As the court of appeals observed, "|o|dd it would be indeed to shield payments from escrow simply because an ousted insider at some other corporation has been similarly enriched." Pet. App. 96a. An "industry prac-

tice" approach would not only unjustifiably shield wrongdoers, but it would also multiply the complexities and burden of applying Section 1103. While the SEC may possess some information regarding the amount of compensation paid to executives at other companies, any consideration of "industry practice" would require the SEC to obtain, both from the company under investigation and from companies that could possibly serve as a basis for comparison (and that might not cooperate), information bearing on whether those other executives are indeed "similarly situated." The question of what constitutes a "comparable" corporation—including whether comparability should be judged by industry, revenues, assets, return-on-investment, corporate governance structure, or some other factors—is fraught with ambiguity, as is the question of how many comparisons the SEC would have to present to show that a payment to a corporate insider deviates sufficiently from the "ordinary."

Such ancillary investigations and proceedings are anathema to the aim of Section 1103. By congressional design, Section 1103 temporarily preserves the status quo while an SEC investigation continues. Thus, Section 1103 escrows will often be sought on an expedited (or emergency) basis. See Pet. App. 102a (Reinhardt, J., concurring in the result). Congress would not enact a provision designed to provide short-term protection to corporate assets in fluid circumstances, while simultaneously imposing such crippling constraints on its use. Cf. *SEC* v. *McCarthy*, 322 F.3d 650, 659 (9th Cir. 2003) (noting importance of SEC's ability to use congressionally enacted summary proceedings for vigorous fulfillment of its enforcement functions).

Equally unavailing is petitioners' contention that Section 1103 should be applied only when the payments are "improper * * * in some proven respect," Pet. 17, which they equate with embezzlement or payments otherwise lacking formal corporate approval. Pet. 17-20. Section 1103 contains no indication that its application should be so limited. It does not use the term "improper"; rather, it uses the term "extraordinary," and expressly states that "extraordinary payments" may include "compensation." 15 U.S.C. 78u-3(c)(3)(A)(i) (Supp. II 2002). The term "extraordinary payments" admits of no reading that is limited to "pilfered" payments or those otherwise not authorized by the board of directors. See Pet. 20. If Congress had intended such a meaning, it could easily have included such a limit in the statute. Moreover, since Section 1103 comes into play only when an SEC investigation is *ongoing*, the SEC could not be expected to have already reached a conclusion regarding the "proper" or "improper" nature of a particular payment.

c. In any event, petitioners point to nothing in the court of appeals' interpretation of Section 1103 that would merit this Court's intervention. Petitioners do not assert the existence of a circuit conflict; indeed, they do not cite any other appellate decision construing Section 1103 in any respect. Nor do petitioners suggest any other basis for the exercise of certiorari jurisdiction. This question is therefore not worthy of review.

2. Petitioners also err in contending (Pet. 21-25) that Section 1103 violates the Fourth Amendment's proscription against unreasonable seizures. As the court of appeals held, the Section 1103 escrow process is reasonable and does not offend Fourth Amendment principles. See Pet. App. 70a n.1.

The Fourth Amendment's warrant requirement and its concomitant probable-cause standard do not apply to Section 1103 escrows. As this Court has repeatedly emphasized, the touchstone of the Fourth Amendment is "reasonableness." *Board of Educ.* v. *Earls*, 536 U.S. 822, 828 (2002); *Illinois* v. *McArthur*, 531 U.S. 326, 330 (2001); *Soldal* v. *Cook County*, 506 U.S. 56, 71 (1992). Warrantless administrative searches and seizures directed at "closely regulated" businesses are reasonable under the Fourth Amendment if the government's interest is substantial, the process is necessary to further the regulatory scheme, and the program is "a constitutionally adequate substitute for a warrant." Pet. App. 70a n.1 (citing *New York* v. *Burger*, 482 U.S. 691, 702-703 (1987)).[5] Such is the case here.

First, the SEC has a substantial interest in investigating the persons and entities it regulates without risk-

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[5] Petitioners contend (Pet. 24) that *Burger* is inapposite, because it involved "*searches*" rather than seizures, and the "time, place and scope" of the searches was limited there. But this Court has never suggested that seizures are subject to more rigorous standards than searches. See, *e.g.*, *McArthur*, 531 U.S. at 330-331 (discussing the Court's flexible approach to "warrantless search[es] or seizure[s]" in cases involving "special law enforcement needs, diminished expectations of privacy, minimal intrusions, or the like"). If anything, the Section 1103 regime is farther removed from the criminal process than the administrative inspection at issue in *Burger*. See 482 U.S. at 716-717 (inspecting officers may discover evidence of crimes during administrative inspection, and police officers may conduct the inspection). Moreover, the Section 1103 process is limited in time, place, and scope: the escrow order may last no more than 90 days in the absence of an SEC enforcement action, and, in the event an action is filed, the order may not last beyond the conclusion of the proceeding; the escrow order may only be entered by a federal district court; and the order may extend only to "extraordinary payments." 15 U.S.C. 78u-3(c)(3)(Supp. II 2002).

ing the dissipation of funds that may compensate victims of securities violations; indeed, courts have long held that measures to prevent such dissipation further an important public interest. See, *e.g.*, *SEC* v. *Infinity Group Co.*, 212 F.3d 180, 197 (3d Cir. 2000), cert. denied, 532 U.S. 905 (2001); *SEC* v. *Lauer*, 52 F.3d 667, 671 (7th Cir. 1995) (asset freeze "was and is essential to prevent the dissipation of assets"). Second, by permitting the SEC to seek the temporary escrow of corporate assets while it conducts its investigation into possible violations of the securities laws, Section 1103 "add[s] necessary teeth to the Commission's ability to perform its mission" to protect investors by "ensur[ing] that recovery by way of disgorgement, etc., is effective rather than empty." Pet. App. 97a. Third, the Section 1103 escrow process—by which the SEC must apply to a district court for an escrow order and anyone affected by the escrow has an opportunity to respond—adequately substitutes for a warrant.

Finally, the facts that a Section 1103 escrow order (1) is not part of a criminal prosecution; (2) is temporary; and (3) does not reveal private information further support the court of appeals' conclusion that Section 1103 is reasonable. See *Earls*, 536 U.S. at 828 (probable-cause standard "is peculiarly related to criminal investigations"); *United States* v. *Place*, 462 U.S. 696, 703 (1983) (discussing "exception to the probable-cause requirement for limited seizures" and observing that whether a seizure is reasonable turns on a balancing of "the nature and quality of the intrusion * * * against the importance of the governmental interests").

Petitioners suggest that the burden on them is substantial because the termination payments have been escrowed until resolution of the SEC's case against

them, which could last "months or years." Pet. 24. But that argument goes only to the post-complaint continuation of the escrow, and petitioners consented in the district court to the continuing escrow, see note 3, *supra*. In any event, the continuation of the escrow is attributable to the fact that the SEC has filed a lawsuit charging petitioners with federal securities law violations. See 15 U.S.C. 78u-3(c)(3)(B)(i). In those circumstances, the balancing of interests even more strongly favors the government, and the escrow remains subject to judicial oversight. Petitioners' Fourth Amendment challenge is thus entirely without merit.

3. Petitioners contend (Pet. 25-27) that Section 1103, as applied to them, is unconstitutionally vague under the Fifth Amendment's Due Process Clause. Their vagueness challenge is based on their claim that, before they and Gemstar agreed in November 2002 to postpone the termination payments, the SEC allegedly "did not clarify its position on the breadth of Section 1103." Pet. 25. That fact-bound contention does not merit further review.

Although petitioners suggest (Pet. 25) that the "SEC [m]isled" them, their underlying factual contention is merely that the SEC "appeared" to admit that it would not seek an escrow of that part of the termination payments purportedly attributable to vacation pay, and that the SEC at that time "did not clarify its position." Pet. 25. In reality, the SEC consistently maintained that the termination payments in their entirety were potentially subject to a Section 1103 escrow. Indeed, petitioners' agreements with Gemstar expressly recognized that the SEC might ask that "all or a portion" of the $37 million be placed "into an escrow pursuant to the Sarbanes-Oxley Act." C.A.E.R. 7-8; see Pet. App. 26a.

Moreover, the SEC had no obligation to inform petitioners whether it would seek a Section 1103 escrow of the entire $37 million before it actually applied for the escrow. The SEC did not breach any agreement with petitioners and did not cause them to incur any liability they might otherwise have escaped. The only case on which petitioners rely, *Chalmers* v. *City of Los Angeles*, 762 F.2d 753 (9th Cir. 1985), is readily distinguishable. There, faced with one city ordinance that appeared to bar a vendor's T-shirt sales and another ordinance that appeared to allow her sales, the vendor consulted the City Clerk's Office, which "assured her that her planned activities were permitted." *Id.* at 756. When the vendor tried to sell her shirts, however, "she was harassed, threatened with arrest and prosecution, and ultimately prevented from selling the T-shirts" by police who contended the sale was illegal. *Ibid.* The *Chalmers* court held that the city deprived the vendor of due process by taking action against her for activity that the city had assured her was legal. *Id.* at 759. Nothing remotely analogous occurred here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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